

GLOBAL BUSINESS LEADER SURVEY: RISK PRIORITIES AND PREPAREDNESS

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ABOUT THIS REPORT

This Lloyd's 360 Risk Insight research report explores corporate risk attitudes around the world. It was produced in collaboration with the Economist Intelligence Unit.

The research is based on a worldwide survey of more than 570 board-level executives, which was conducted in March 2009. Respondents were spread evenly across the major regions of the world, and represented a broad range of sectors and company sizes. The charts below outline details of the distribution of respondents across these demographic segments. To provide further insight and analysis on the findings, a series of in-depth interviews was conducted with corporate leaders and risk experts in the field.

The survey examined attitudes to risk across five key categories:

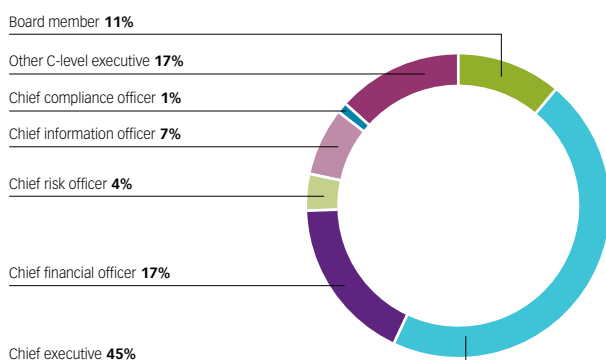
- Economic, regulatory and market risk
- Business and strategic risk
- Political, crime and security risk
- Environmental and health risk
- Natural hazard risk

Respondents to the survey were asked to score a series of key risks within these categories in relation to two measures: first, the priority level for the risk in their organisation; and second, the degree of preparedness to manage it. The survey responses were then divided into regions and a single score for priority and preparedness was calculated using a weighted average of the responses. On this scale, a score of zero represents the minimum possible level of priority and preparedness, and a scale of ten represents the maximum possible level.

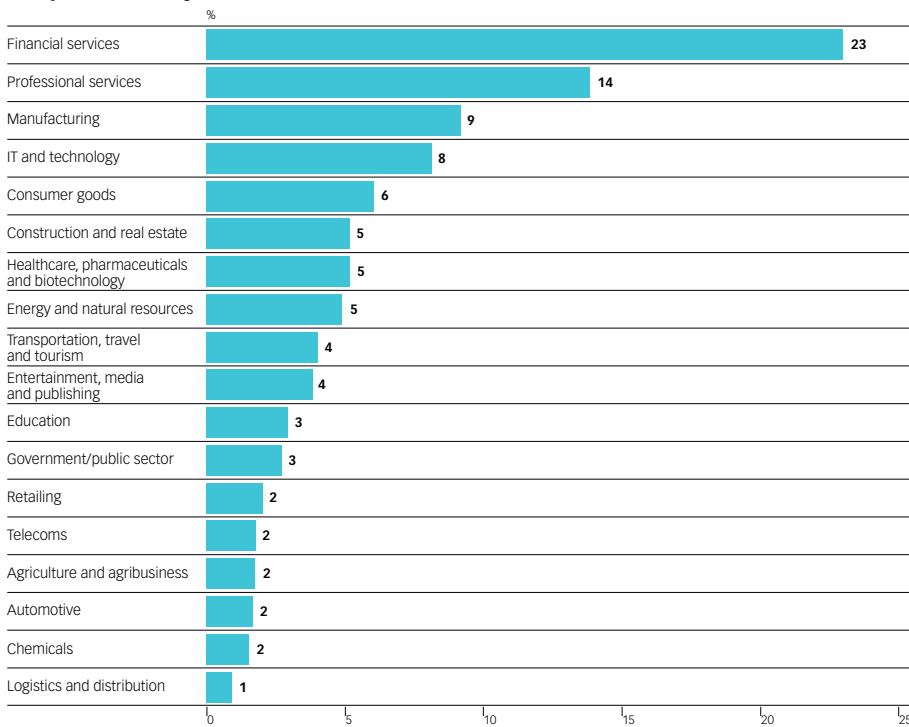
The report provides analysis of the survey findings, at a global level and within key regions of the world. It also includes a section on changing attitudes to risk and approaches to management at a global level, which was produced on the basis of a series of in-depth interviews with risk experts.

A significant number of people have been involved with the compilation of this report and we are very grateful to our survey respondents and interviewees for their time and insight.

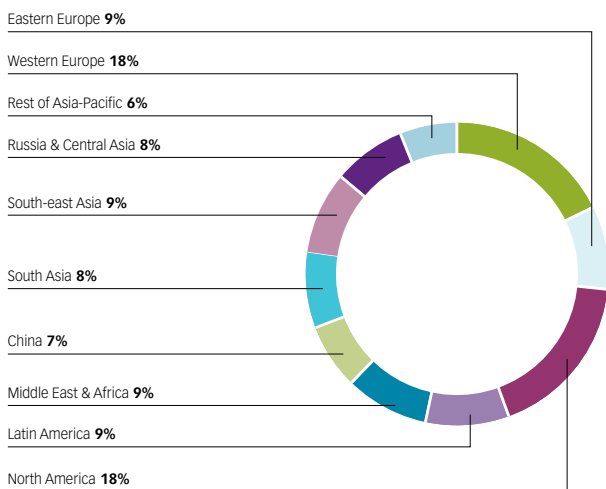
Respondents by job title



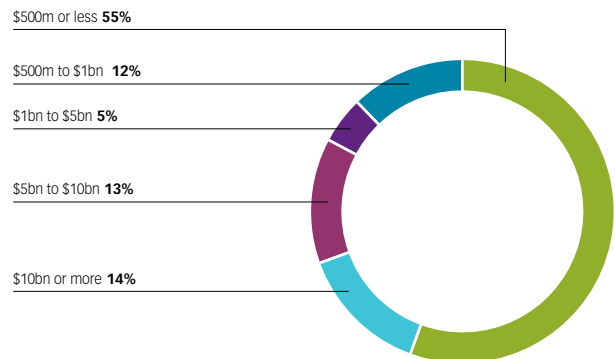
Respondents by sector



Regional breakdown



Respondents by company size



EXECUTIVE SUMMARY

The global financial and economic crisis has caused a fundamental reassessment of risk. In the early years of this decade, when the pricing of risk was at an historic low in credit markets, and finance was cheap and easily accessible, companies around the world pursued increasingly bold strategies. Mergers and acquisitions grew in scale and ambition, financed by high levels of leverage, and corporates expanded their geographical and market reach to take advantage of the boom.

Since late 2007, the contraction of credit in financial markets and the subsequent economic downturn has had a dramatic impact on corporate confidence. Across the full range of regions and industries, companies are postponing investment, cutting costs and retrenching into core markets. In the most general terms, they are reining in their risk appetite, and paying closer attention to the way in which risks are identified, assessed and mitigated. For risk managers, these are highly demanding times: after a period of years when they were viewed as naysayers intent on applying the brakes to corporate strategy, they are now taking centre stage as senior executives apply a more stringent risk filter to their activities and seek to demonstrate that they have undertaken a full assessment of the threats that they face.

At a time of major upheaval in the global economy, it is crucial to maintain an understanding of how perceptions of risk are changing and the extent to which companies are prepared to manage these risks. Senior executives in the world's leading organisations must not only navigate their way successfully through uncertain times, but they must also take the kind of calculated risks that are necessary for growth.

To explore these issues, Lloyd's commissioned the Economist Intelligence Unit to conduct a survey of more than 570 board-level executives from around the world. The findings of this research offer a comprehensive picture of the risk environment for corporate executives and risk managers.

As well as providing a snapshot of the current risk concerns of global business leaders, Lloyd's will use this survey to help populate a Lloyd's 360 Risk Map. This interactive online map, to be launched in early 2010, will display emerging risk hotspots and changing levels of risk around the world. It will also provide the latest information and news on emerging risk. Lloyd's intention is to conduct this risk survey of global executives annually, so that it can track changes in executives' risk priorities and preparedness in different regions of the world and identify key trends on the Risk Map.

In this report, we examine how executives from nine global regions perceive the current risk environment. More specifically we investigate their risk priorities and the extent to which they feel prepared to deal with these risks. We also explore how local context and attitudes are shaping risk management around the world.

Key findings of this research include the following:

COMPANIES ARE RETREATING FROM RISK-TAKING AS THE GLOBAL ECONOMIC DOWNTURN CONTINUES TO BITE.

The combination of a synchronised global downturn and financial crisis has had a dramatic impact on the willingness of companies to take risks in order to grow their business. While companies may be prevented from implementing strategic initiatives because of a lack of affordable credit, the survey suggests that, more generally, there is an aversion to activities that could have a negative impact on earnings in the short- and medium-term. More than half of companies globally say

they have reduced their appetite for risk, compared with one year ago, whereas less than one in five indicate that their appetite for risk has increased. Manufacturing companies are most likely to say they plan to reduce appetite for risk, with 60% indicating that they will do this, followed by 59% of financial services companies and 57% of information technology firms. Looking at the results by region, respondents from Russia, Eastern Europe and Latin America are most inclined to have reduced their appetite for risk.

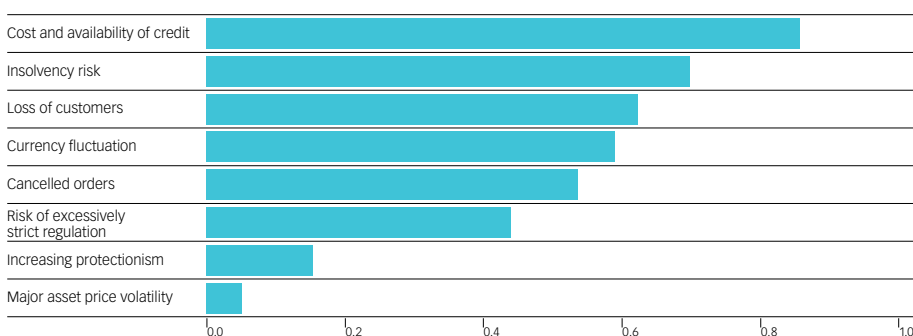
THE ECONOMY IS CURRENTLY DOMINATING THE RISK MANAGEMENT AGENDA.

With many companies around the world currently preoccupied with survival, it is understandable that fears about the economy will be foremost in the minds of senior executives. Among the top ten global risk priorities, all of the risks are either directly or indirectly related to the economy. The cost and availability of credit leads the list, followed by currency fluctuation, insolvency risk, loss of customers, major asset price volatility, cancelled orders and the risk of excessively strict regulation. All of these concerns can be directly attributed to the current economic crisis. Corporate liability and reputational risk can, arguably, be viewed as indirectly linked to the financial crisis, whereas project delivery risk will in many cases be directly related, given the reduced margin for error under which more cash-strapped companies are operating.

COMPANIES FEEL LESS PREPARED TO DEAL WITH EXOGENOUS RISKS.

The risks in our survey can be divided into two main categories: 'internal risks' that fall within the walls of the company, which can be controlled by executives, and 'exogenous risks', relating to external factors over which managers have only limited, indirect control. Reputational risk and corporate liability, for example, can be termed as internal risks, which boards can mitigate by using insurance or improving management in some way. Other risks, such as the insolvency of customers, or the cost and availability of credit, can be called exogenous risks because they cannot be mitigated directly using insurance or management. In general, survey respondents are much less prepared to deal with exogenous than internal risks. The chart below highlights this by showing the risks where levels of preparedness lag most severely behind the priority. That such a gap should exist in the case of many of these risks is not surprising. Given the difficulty of taking control of these risks, however, companies must find indirect ways of managing their impact through strategic and operational planning.

Chart 1: The preparedness gap

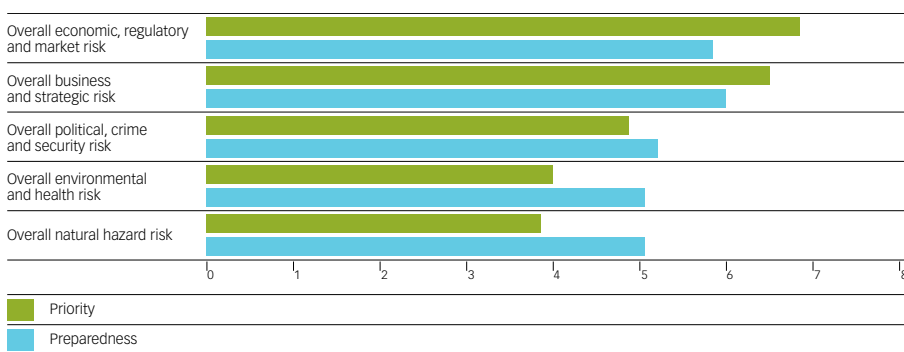


This chart shows the eight risks for which levels of preparedness lag most behind the perceived priority. The scale refers to the difference between the priority and the preparedness scores, where a positive integer indicates that executives feel that their preparedness is insufficient.

ENVIRONMENTAL AND NATURAL HAZARD RISKS ARE SEEN AS LOW PRIORITY.

The extent to which macroeconomic factors have taken over the risk management agenda raises the question of whether companies are sidelining other, vital risks in their efforts to navigate their businesses through the current economic downturn. Certainly, the dominance of economic risks means that the overall categories of ‘environmental and health risk’ and ‘natural hazard risk’ are relatively low on the priority list (see chart below). Although respondents claim that they are well prepared to manage these categories, their low priority suggests that there may be gaps emerging in the ability of companies to withstand some longer term and ‘tail risks’.

Chart 2: Risk priorities and preparedness for overall categories

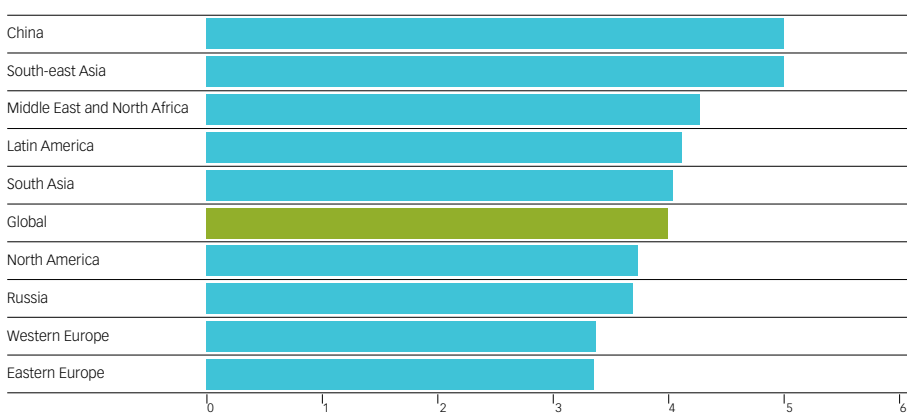


This chart shows priority levels in green and preparedness levels in blue for five broad risk categories. The scale indicates the overall ‘score’ for the risk, which has been calculated using a weighted average of all responses. A score of zero on the scale represents the minimum possible level of priority and preparedness, and a score of ten represents the maximum possible level.

EXECUTIVES IN ALL REGIONS SHARE SIMILAR PRIORITIES WHEN IT COMES TO THE ECONOMY AND BUSINESS STRATEGY, BUT THERE IS GREATER DIVERGENCE IN OTHER RISK CATEGORIES.

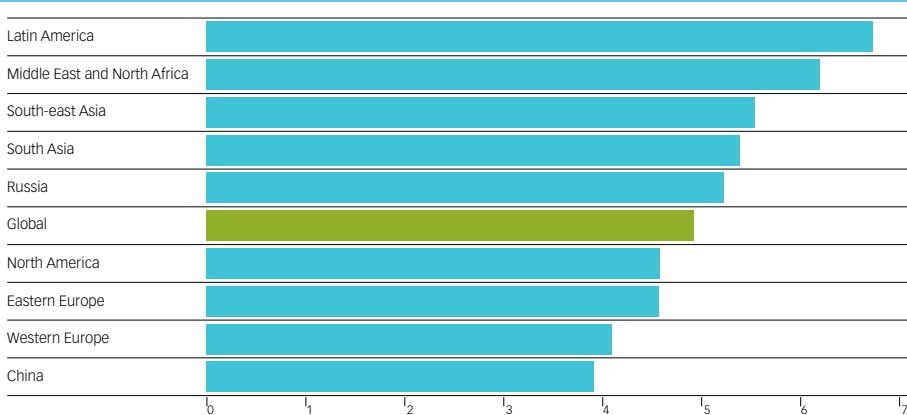
The overall categories of ‘economic, regulatory and market risk’ and ‘business and strategic risk’ are given broadly similar priority ratings across the regions, but there is greater divergence when it comes to ‘political, crime and security risk’ and ‘environmental and health risk’. In general, less developed markets are more likely to give a high priority rating to political, crime and security risk, or environmental and health risk. For example, respondents in China and South-East Asia assign a considerably higher priority to environmental and health risk than those in other regions of the world, whereas those from Latin America, the Middle East and North Africa are most concerned about political, crime and security risk. Meanwhile, respondents from China are least concerned about political, crime and security risk.

Chart 3: Environmental and health risk – a regional perspective



The chart above shows the countries and regions for which environmental and health risk is of greatest and least concern. The overall level of concern of global aggregate respondents appears in green.

Chart 4: Political, crime and security risk – a regional perspective



The chart above illustrates the countries and regions for which political, crime and security risk is of greatest and least concern. The overall level of concern of global aggregate respondents is shown in grey.

GLOBAL AND REGIONAL RISK ASSESSMENTS

“MANY OF THE HIGHEST PRIORITY RISKS RELATE TO CHANGES IN THE MACROECONOMIC ENVIRONMENT.”

As the basis for this report, the Economist Intelligence Unit questioned 570 board-level executives from around the world about their perception of key risk categories and the extent to which they believe that their company is able to manage them. In the section that follows, we first report on the global perspective, looking at the responses of executives in regions around the world. Then, we consider the responses from the nine regions in turn, highlighting the differences and similarities in the outlook of respondents.

GLOBAL VIEW

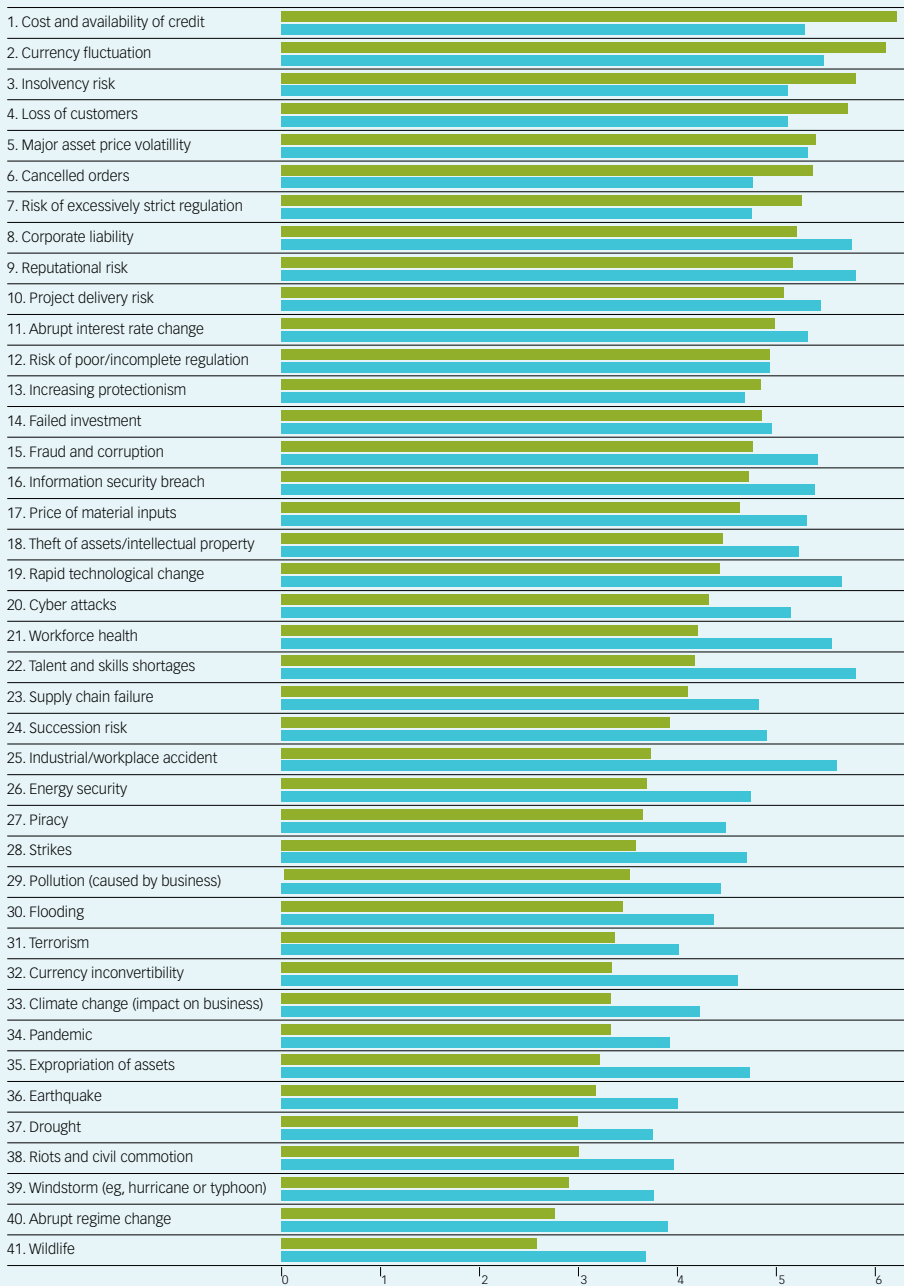
The chart below ranks all risks surveyed in order of priority for all respondents. The red bar on the chart refers to the overall priority for the risk, whereas the grey bar indicates the degree of preparedness to manage each particular risk. If the grey bar matches or exceeds the red bar in length, it means that the executives surveyed believe that they are well prepared to manage a particular risk. In general, preparedness levels are fairly high across the survey, but one should not ignore the fact that, for many companies, there will be a difference between being prepared, and thinking that they are prepared. As the global financial crisis has shown, companies might feel overconfident about the extent to which they can manage the risks that they face.

The findings highlight several broad trends about risk perceptions in the world's boardrooms. First, the economy dominates risk assessment. Many of the highest priority risks relate to changes in the macroeconomic environment. Second, risks concerning natural hazards, and longer term trends such as climate change, tend not to be of great and immediate concern to board-level executives. These so-called 'tail risks', which have a small probability but a high impact, tend to be low on the priority list. Finally, there is a distinction between risks that originate within the company and its supply chain, and those that pertain to the external environment. In general, respondents feel well prepared to deal with internal risks, which fall within the walls of the company, such as reputational risk and corporate liability, no doubt because they are likely to have been discussed widely in boardrooms.

Global risk

The chart opposite shows the findings for all risks covered in the survey, based on the responses of all 570 board-level executives. The risks are listed in order of concern, with priority levels shown in green and preparedness levels in blue. The scale refers to a score, based on the responses, which has been calculated using a weighted average. A score of zero on the scale represents the minimum possible level of priority and preparedness, and a score of ten represents the maximum possible level.

Chart 5: Global Risk Chart



TOP TEN GLOBAL RISK PRIORITIES

“COMPANIES AROUND THE WORLD HAVE BEEN STARVED OF THEIR LIFEBLOOD - ACCESS TO FINANCE.”

1. COST AND AVAILABILITY OF CREDIT

Despite unprecedented monetary easing by central banks, credit markets remain log-jammed. Companies around the world have been starved of their lifeblood – access to finance – and many are struggling with the consequences. With the spill-over from financial markets continuing to have a dramatic impact on the real economy, the cost and availability of credit has become the highest priority risk worldwide. As the chart on the previous page illustrates, levels of preparedness lag behind perceived severity, which is perhaps not surprising given that companies are reliant on external sources of finance, and have limited tools at their disposal to address this issue. This is particularly true of smaller companies, which have been disproportionately hit by the crisis because they may lack a high credit rating or diversified access to finance. By comparison, their larger peers tend to be better prepared.

2. CURRENCY FLUCTUATION

Sharp swings in global exchange rates over the past year, particularly for many emerging market currencies, are making it difficult for companies to plan financial strategies and are having a dramatic impact on earnings. Although the second highest priority risk globally, currency fluctuation is generally seen as more severe in emerging markets, and is top of the list of concerns for respondents in China, Eastern Europe, Latin America, Middle East and North Africa, Russia and South-East Asia. Even though there are techniques available to hedge currency exposures – either through derivatives or a more operational approach – these are likely to be more widely available to companies in developed markets. Overall, it is clear that this risk remains a major concern for an overwhelming proportion of global executives and, again, their level of preparedness does not appear to be commensurate with the scale of the risk.

3. INSOLVENCY RISK (WHICH INSOLVENT COMPANIES POSE TO THE BUSINESS)

During the more benign economic environment that existed before the current financial crisis, the risk that business partners, suppliers or customers might become insolvent was less of a concern. High earnings across the corporate world reduced the risk that companies would fail, and credit insurance was readily available to provide protection against the insolvency of customers. But in the wake of the economic downturn, the rate of corporate defaults has risen, whereas credit insurance has become increasingly scarce. Together, these trends are causing considerable concern for companies, as well as eroding confidence in potential business partners. Given the limited control that companies have over this risk, it comes as no surprise that respondents feel relatively unprepared to manage it.

4. LOSS OF CUSTOMERS

Surveys around the world demonstrate a significant drop in consumer and business confidence over the past 18 months, while credit scarcity and the rush to reduce debt levels are causing major cutbacks in household and business expenditure. Although some forward-looking data suggests that the rate of deterioration is slowing, it is clear that the reluctance of businesses and consumers to commit to purchases is having a dramatic impact on sales at many companies. For many, survival in the medium term depends on the restoration of confidence – something that is by no means certain over the next few months. Again, respondents feel poorly prepared to manage this risk in relation to its severity.

“ANOTHER BOUT OF TURMOIL IN THE MARKETS REMAINS A KEY CONCERN FOR EXECUTIVES.”

5. MAJOR ASSET PRICE VOLATILITY

The unprecedented nature of the current financial and economic crisis led to massive volatility in capital markets as traders tried to make sense of a highly uncertain situation. Between September 2008 and January 2009, the Vix Volatility Index – known as Wall Street’s fear gauge – rose to record highs as swings in asset prices caused mayhem in global markets. Although volatility has calmed considerably since March 2009, with equity prices across many indices posting record rallies, it is clear that another bout of turmoil in the markets remains a key concern for senior executives. Preparedness levels for this risk lag behind the perceived severity, but only slightly.

6. CANCELLED ORDERS

At a time when cash is in short supply, and when there is often little flexibility on balance sheets to weather unexpected shocks, the cancellation of a contract or large order strikes fear into the hearts of senior executives. The problem can be especially serious because, in some cases, an investment might have already been made – in parts, labour and other inputs – and, unless there are contractual clauses offering protection, no revenues will emerge from the expenditure. The fear for many executives is also that, as insolvencies mount and as companies take ever more drastic steps to rein in capital expenditure, the likelihood that orders will be cancelled increases. The unpredictable nature of this risk ensures that respondents feel relatively unprepared to manage it.

“CORPORATE LIABILITY HAS BEEN RISING STEADILY ON THE RISK AGENDA FOR SEVERAL YEARS.”

7. RISK OF EXCESSIVELY STRICT REGULATION

The fear that regulators will formulate a disproportionate response to current economic problems is matched by a consensus that little can be done to prepare for this eventuality. While the risk of excessively strict regulation is most serious for the financial services industry, respondents from other industries, including telecoms and healthcare, also identify it as a threat. Many executives will recall regulatory responses to previous crises, such as the US Sarbanes-Oxley Act in the wake of the corporate governance scandals earlier this decade, and conclude that regulators do not always have a strong track record of devising an appropriate response to corporate wrongdoing. Again, compared with other risks in the top ten, respondents exhibit relatively low preparedness for this risk, no doubt because they feel that they have little control over it. The survey examined the risk of poor or incomplete regulation, and although this does not appear in the global top ten, coming 12th on the priority list, it tends to be seen as a much greater threat in developing countries, where the regulatory infrastructure may be less mature.

8. CORPORATE LIABILITY

Corporate liability has been rising steadily on the risk agenda for several years. Even though it is generally seen as a much greater problem in the United States, aspects of the US litigious culture have started to make their way across the Atlantic and Pacific Oceans. For example, it reaches the top ten priority list in Western Europe, Eastern Europe, South-East Asia and South Asia, in addition to North America. A 360 Risk Insight report on liability, entitled ‘Directors in the Dock’ (2008), found that 55% of businesses believe that a ‘US-style compensation culture’ is spreading around the world. It is interesting to note that respondents seem to feel fairly well prepared to address corporate liability issues. This may, in part, be because they are able to take out Directors and Officers insurance products, which can limit liability.

9. REPUTATIONAL RISK

Often called ‘the risk of risks’, reputational risk is notable for being among the top ten risks by priority, but it is also among the top five risks in terms of levels of preparedness. The fact that it scores so highly on both lists illustrates the extent to which reputational risk management has risen in profile on the corporate agenda in recent years. Reputational issues, related to brand integrity and long-term relationships with the full spectrum of stakeholders, have become a central part of board discussions, and companies around the world are seeking increasingly systematic ways of identifying, quantifying and managing their reputational risk exposure.

10. PROJECT DELIVERY RISK

Companies have always faced the risk that a project might be delayed, exceed the budget or not be completed at all. In some respects, however, the financial crisis has exacerbated project delivery risk because many of the issues listed above, such as cost and availability of credit and insolvency risk, are placing additional obstacles in the way of the smooth completion of projects. Again, companies feel reasonably well prepared to manage this particular risk, perhaps in recognition of the fact that most aspects of this risk fall within their control.

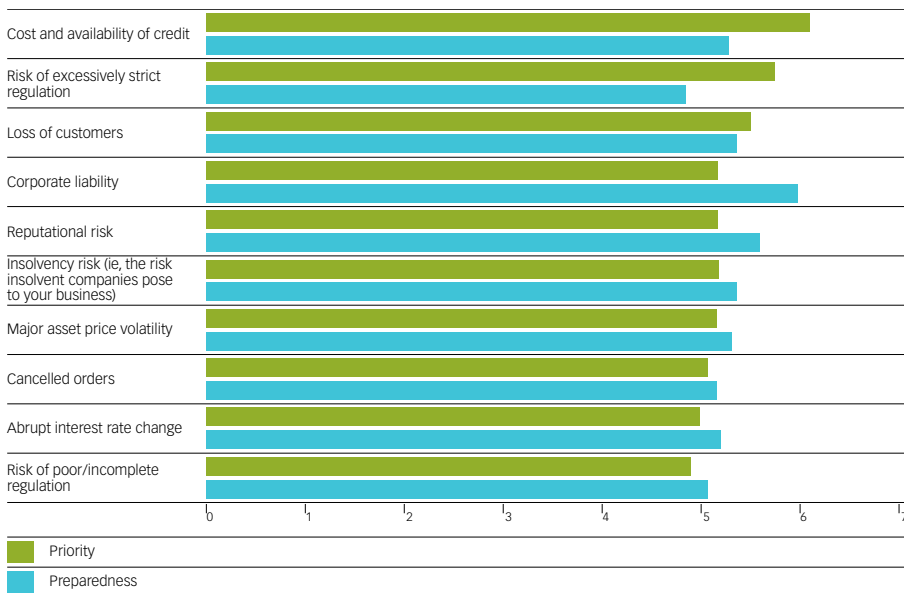
**“THE FINANCIAL
CRISIS HAS
EXACERBATED
PROJECT
DELIVERY RISK.”**

THE LEVEL OF TOXIC ASSETS IN US BANKS HAS STILL NOT BEEN FULLY DETERMINED.



REGIONAL RISK OVERVIEW: NORTH AMERICA

Chart 6: The top ten risks for North America



“THE REGION HAS ENDURED A MASSIVE EROSION OF CONFIDENCE IN ITS BUSINESS INSTITUTIONS, FINANCIAL SYSTEMS AND CORPORATE LEADERS.”

The business environment in North America has changed fundamentally over the past two years. As the epicentre of the global financial and economic crisis, the region has endured a massive erosion of confidence in its business institutions, financial system and corporate leaders. The knock-on effects have been significant and have certainly damaged the continent’s financial and business reputation.

The extent to which North America has been affected by the downturn is all the more striking given that the US and Canada continue to be perceived as highly responsive and competitive economies. The US, for example, tops the list of 134 countries in the World Economic Forum’s 2008-09 Global Competitiveness Index. Canada is ranked tenth.

With banks in the US and, to a much lesser extent, Canada, still reeling from the effects of the financial crisis, the cost and availability of credit remains the number one risk priority for North American executives. This uncertainty about the US financial system is expected to persist for a number of months. Stress-testing of the major banks has provided little comfort to borrowers, many of whom remain dubious about the efficacy of these tests and are struggling to continue financing already high borrowings. Moreover, the level of toxic assets in US banks has not been fully determined, putting the brakes on banks’ willingness to lend. There is, however, markedly less concern about the Canadian banks, which have weathered the financial crisis far better thanks to more effective regulation and more restrained mortgage-lending policies.

“THE IMPACT OF SARBANES-OXLEY APPEARS TO BE STILL FRESH IN THE MIND OF MANY EXECUTIVES.”

The second priority for North America respondents is deeply intertwined with the financial crisis: the risk of excessively strict regulation (a related risk – poor or incomplete regulation – is ranked further down the priority list). Failures in corporate governance, particularly in US banks but also more generally across the corporate world, are coming under intense scrutiny from regulators. Already, the US administration has proposed reform to the regulatory structure governing the US financial system, which would include the granting of systemic risk regulation powers to the Federal Reserve. So far, the response from US regulators has been cautious although, over time, it is expected to be significant.

This more measured approach stands in marked contrast to the response to corporate governance scandals earlier this decade, which resulted in the draconian Sarbanes-Oxley Act that aimed to tighten accounting standards for listed companies. Many executives within the region feel that Sarbanes-Oxley went too far in its remit, leaving US companies at a disadvantage to many of their international counterparts. The impact of Sarbanes-Oxley appears to be still fresh in the minds of many executives, who fear the potential impact of excessively strict regulation. In particular, an atmosphere of rising protectionism and state bailouts may have enhanced fears of more government and bureaucratic involvement in the economy. For example, the US president, Barack Obama, has said, that a cap-and-trade system to combat carbon emissions will be introduced by his administration, although the impact on business of climate change itself is far less of a priority, ranking 37th place out of 41 in both the priorities and preparedness lists.

Loss of customers remains a powerful concern for North American respondents, coming third on the list of priorities. Recent data from the Conference Board Consumer Confidence Index supports this view. Although the index strengthened considerably in April and May (the index leapt to 54.8 in May compared with 40.8 in April), it then fell back in June to 49.3 – a move that surprised many economists. In Canada, the picture is slightly more positive, with the Conference Board of Canada’s Index of Consumer Confidence having risen in May for the third consecutive month.

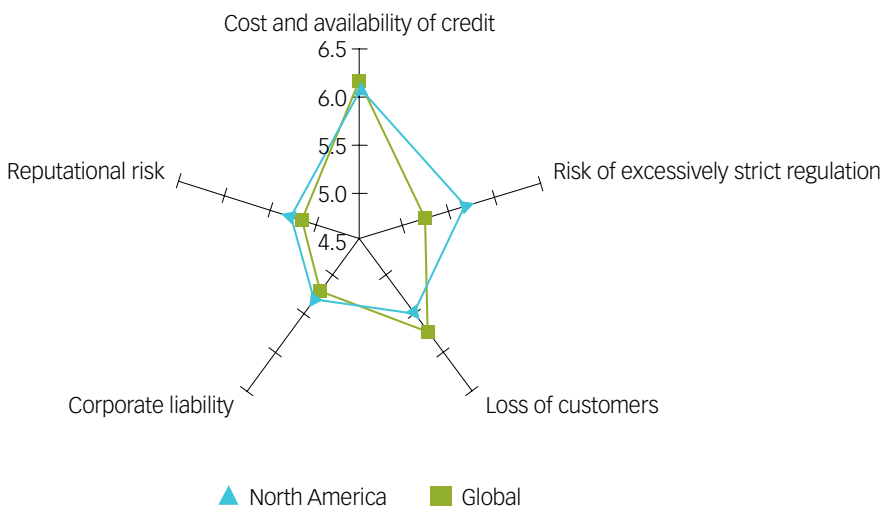
The fourth and fifth priorities – corporate liability and reputational risk – differ from the others in the top ten in that companies can exert greater control over these risks. Corporate liability, in particular, is a familiar risk to North American companies, and one that already attracts a considerable amount of boardroom attention. For this reason, respondents indicate that they are well prepared to address this risk, although the potential for class action suits and other liability cases arising from the financial crisis could open up a whole new front on which companies might have to fight legal battles.

Companies in the region are clearly worried about the viability of companies with which they deal. The risk of insolvency and the risk of cancelled orders also rank in the top ten (at sixth and eighth respectively). Certainly, corporate defaults are on the rise in North America. Standard & Poor’s (S&P), a rating agency, predicts that there will be 209 corporate defaults by the end of 2009 in the US, an increase of 117% on the previous year, and 36 more than in 2001, when the dotcom bubble burst.

“CERTAINLY CORPORATE DEFAULTS ARE ON THE RISE IN NORTH AMERICA.”

One aspect that is worth noting is the relatively high degree of preparedness that North American businesses claim is in place to manage many of their top priority risks. Out of the ten most severe risks, there are seven for which levels of preparedness exceed the perceived level of priority. This probably reflects the relatively high level of maturity that risk management has attained on the continent. That said, the risk priorities for which respondents say they are least prepared are the top three priorities: cost and availability of credit, the risk of excessively strict regulation and loss of customers.

Chart 7: Top five risk priorities – comparison between North American and global respondents



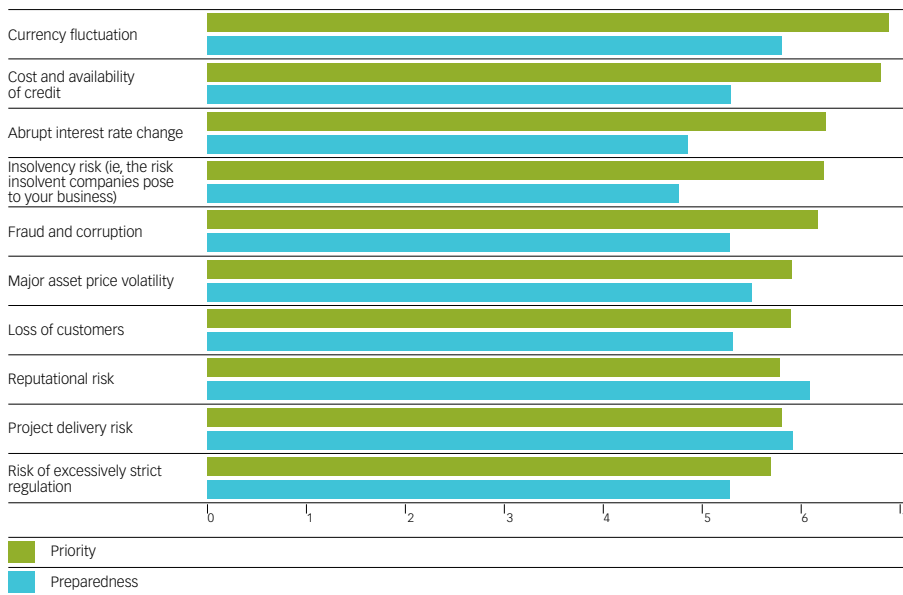
This graph compares the North American view of the top five risk priorities with the global view of the same risks. In general, the North American perception follows the global assessment, although respondents in the region are particularly likely to be concerned about the risk of excessively strict regulation.

CURRENCY FLUCTUATION IS THE TOP PRIORITY FOR SENIOR EXECUTIVES IN LATIN AMERICA.



REGIONAL RISK OVERVIEW: LATIN AMERICA

Chart 8: The top ten risks for Latin America



“THE GLOBAL ECONOMIC CRISIS HAS EXPOSED THE INSTABILITY AND FRAGILITY OF MANY LATIN AMERICAN COUNTRIES TO EXTERNAL SHOCKS.”

The global economic crisis has exposed the instability and fragility of many Latin American countries in their ability to cope with external shocks and imbalances – although the extent to which countries have been affected by the economic downturn varies considerably and some have shown their resilience. On the one hand, Latin America is no different from other regions in regard to its concern over three core risks: currency fluctuation, the cost and availability of credit and insolvency risk. Respondents in the region are equally honest in their assessment that these are threats for which it is difficult to prepare adequately. On the other hand, idiosyncrasies and the history of the region place two risks within its top five, neither of which is in the global top ten: abrupt interest rate changes, which are driven by a loss of investor confidence in the ability of many countries to weather the current turmoil; and the region’s vulnerability to fraud and corruption.

Currency fluctuation is the top priority for senior executives in Latin America. Chief among the factors behind a rapid deterioration in Latin American currencies – which began in the fourth quarter of 2008 – is a heavy dependence on the US for trade, investment flows and remittances, most notably in Mexico, Central America and the Caribbean. A bleak outlook for the US economy led to falling expectations for future growth and capital inflows for Latin America, prompting many investors to seek a safe haven in the US currency.

“ONLY IN THE CASE OF REPUTATIONAL RISK AND PROJECT DELIVERY RISK DO PREPAREDNESS RATES EXCEED THE PRIORITY LEVEL.”

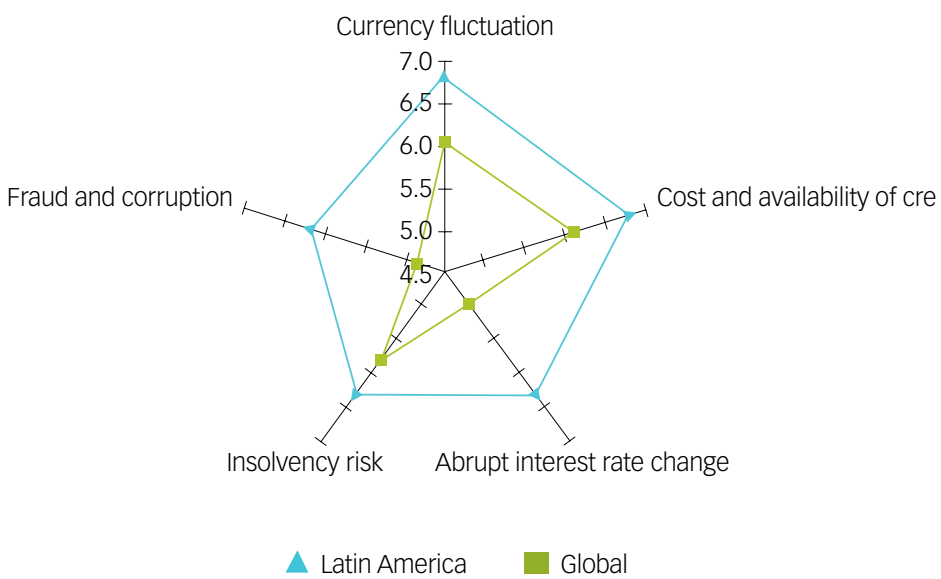
The cost and availability of credit is the second highest risk in this region. Latin America faces a precarious dilemma in financing business; well established companies find few opportunities to issue debt abroad at reasonable costs, yet local capital markets are unable to absorb the demand and need for financing. Despite some deepening in the capital markets of Brazil, Chile and Mexico, most sources of financing in Latin America remain undeveloped. Many large firms will encounter cash-flow problems, making it difficult to meet rising payment obligations or roll over debt, and small and medium-sized firms (SMEs) will find sources of financing have either dried up or come at exorbitant prices.

Monetary easing by lowering interest rates has had little impact on many companies so far, which would explain why abrupt interest rate change remains the third top priority in Latin America. In fact, most firms have seen the cost of their credit increase, rather than fall. Furthermore, a shortening in maturities means that companies need to either seek refinancing or roll over debt, but at uncertain and usually higher costs. Servicing debt has become more expensive and risky since the costs (interest rates) have fluctuated because of continuing weakness in the economy. Indeed, low business expectations for a prompt and deep turnaround make interest rates more vulnerable to widespread swings. Many firms, particularly SMEs, rely on supplier credit, yet interest charges on this have also become more costly and unpredictable. Reluctance among banks and investors to lend money has contributed to stiffer demands for collateral and higher interest rates. In addition, even if banks extend loans, they lend at variable rates, which can fluctuate and thereby increase the risks and interest rate charges for firms.

Fraud and corruption is a longstanding problem in this region, and is likely to get worse as a result of the economic crisis. Problems such as stolen inventories, ‘staged’ thefts when collecting payments for goods and services rendered, and payroll theft are prevalent, while thefts of materials involving the participation or co-operation of personnel inside the company are commonplace. The losses in thefts, combined with the added expense of insurance policies, translate into high operating costs for companies in the region.

Levels of preparedness to meet the top priority risks in Latin America are generally quite low. In the case of the cost and availability of credit, abrupt interest rate change and insolvency risk, the differential between levels of priority and preparedness is much higher than for the global respondents overall. Only in the case of reputational risk and project delivery risk do preparedness rates exceed the priority level.

Chart 9: Top five risk priorities – comparison between Latin American and global respondents



“CONCERNS ABOUT ABRUPT INTEREST RATE CHANGES AND FRAUD AND CORRUPTION WEIGH MORE HEAVILY ON THE MIND OF EXECUTIVES.”

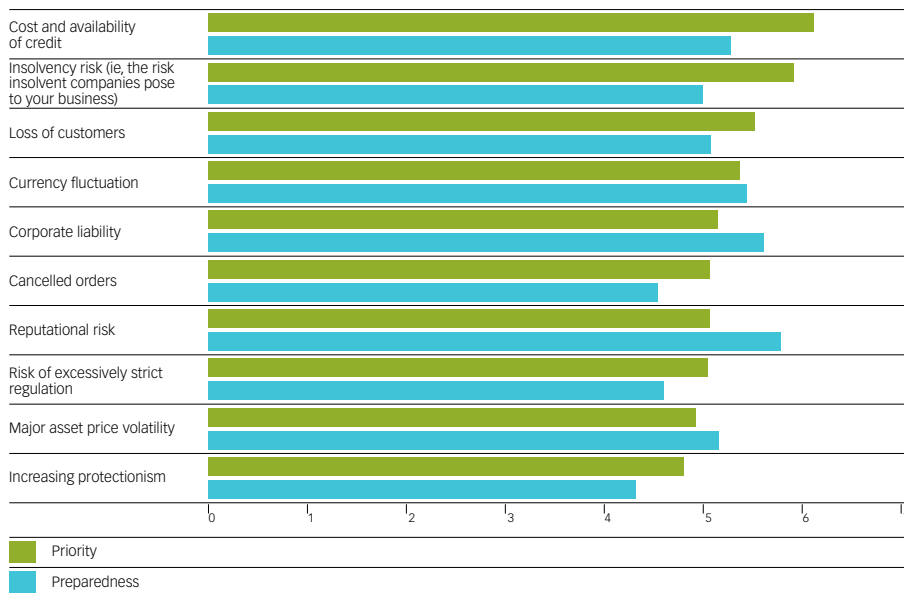
The top five priority risks for Latin America are all seen as significantly more severe by respondents in this region than by the global respondents overall. In particular, concerns about abrupt interest rate changes and fraud and corruption weigh more heavily on the minds of executives in this region than they do on managers in regions elsewhere in the world.

THE GLOBAL ECONOMIC CRISIS LOOMS LARGE OVER RISK PERCEPTIONS IN WESTERN EUROPE.



REGIONAL RISK OVERVIEW: WESTERN EUROPE

Chart 10: The top ten risks for Western Europe



“DESPITE UNPRECEDENTED MONETARY EASING, CREDIT MARKETS REMAIN BLOCKED.”

The global economic crisis looms large over risk perceptions in Western Europe. The most pressing overall priority for executives in the region, as with the global respondent base, is the cost and availability of credit. Despite unprecedented monetary easing by the European Central Bank (ECB) and the Bank of England, credit markets remain blocked. According to the most recent bank lending survey, published by the ECB on 29 April 2009, the net balance of those banks that tightened credit against those that eased it was 43%. Although lower than the percentage that tightened lending in the fourth quarter of 2008, this still represents a pronounced trend towards a decline in availability of lending that has now been in train for seven quarters.

Dealing with insolvency risk is seen as the second highest priority for Western European respondents. This is understandably a widespread concern and is an area in which respondents feel they lack preparedness to meet the scale of the risk. Rating agency Moody's has predicted that corporate defaults for the debt of junk or speculative grade companies will rise to 16.4% – a higher rate than during the Great Depression.

The financial crisis has also led to the withdrawal of protection from insolvency risk. Credit insurance, which protects suppliers against the non-payment of customers, has become increasingly scarce, leaving many companies exposed to significant financial loss if customers become insolvent.

“WESTERN EUROPE IS THE ONLY REGION IN WHICH INCREASING PROTECTIONISM RANKS IN THE TOP TEN LIST OF PRIORITIES.”

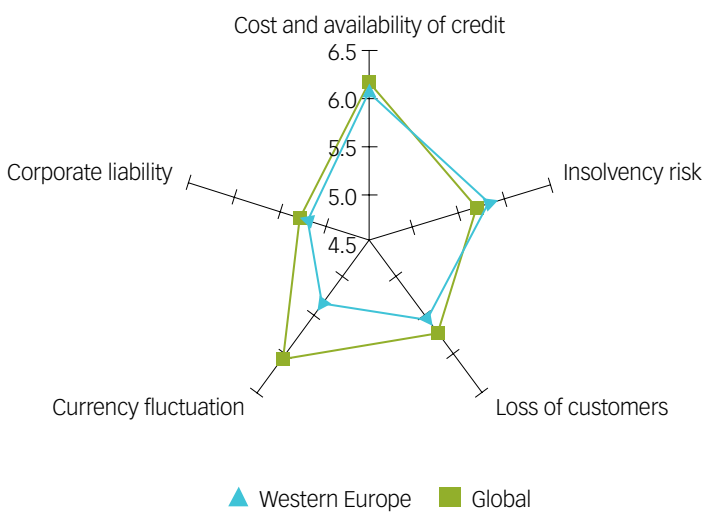
A straightforward loss of customers is seen as the third highest risk priority in the region. Put simply, negative sentiment, credit scarcity and the rush to reduce levels of debt have caused a major retrenchment in household and business expenditure, and this is having a dramatic impact on sales. Consumer and business surveys in the region show a continued decline in overall confidence, although the rate of deterioration started to slow in December 2008. Nevertheless, confidence remains at its lowest level in both the EU and the Eurozone since the start of the data series in early 1985, and this will have a negative impact on companies in terms of lost customers.

Western Europe is the only region in which increasing protectionism ranks in the top ten list of priorities. While political leaders in Europe have generally been supportive of attempts to curb protectionism, actions taken domestically have not always lived up to these expectations. For example, on 9 February 2009, the French government announced a package of aid, including loans, to Peugeot-Citroen and Renault, which were made on the condition that the car-makers would not cut jobs or close plants in France. The implicit conclusion was that any necessary job cuts would need to be made at overseas factories, especially in Eastern and Central Europe, where many French automotive firms have large factories.

Ultimately, in the face of a barrage of criticism, led by Czech Prime Minister Mirek Topolánek, the French government softened its plan. But as the economic downturn continues to bite in Western Europe, and as domestic political pressure mounts on many European leaders, it remains to be seen whether further protectionist moves can be avoided.

Similar to their peers in other developed regions, respondents from Western Europe feel relatively well prepared to deal with most threats on their top ten priority list. In particular, they are confident in their ability to manage risks associated with corporate liability and reputational risk. In recent years, these topics have become a regular fixture of boardroom discussions, so one might expect levels of preparedness to have reached a significant degree of maturity despite the additional problems caused by the financial crisis.

Chart 11: Top five risk priorities – comparison between Western European and global respondents



“THEY ARE CONFIDENT IN THEIR ABILITY TO MANAGE RISKS ASSOCIATED WITH CORPORATE LIABILITY AND REPUTATIONAL RISK.”

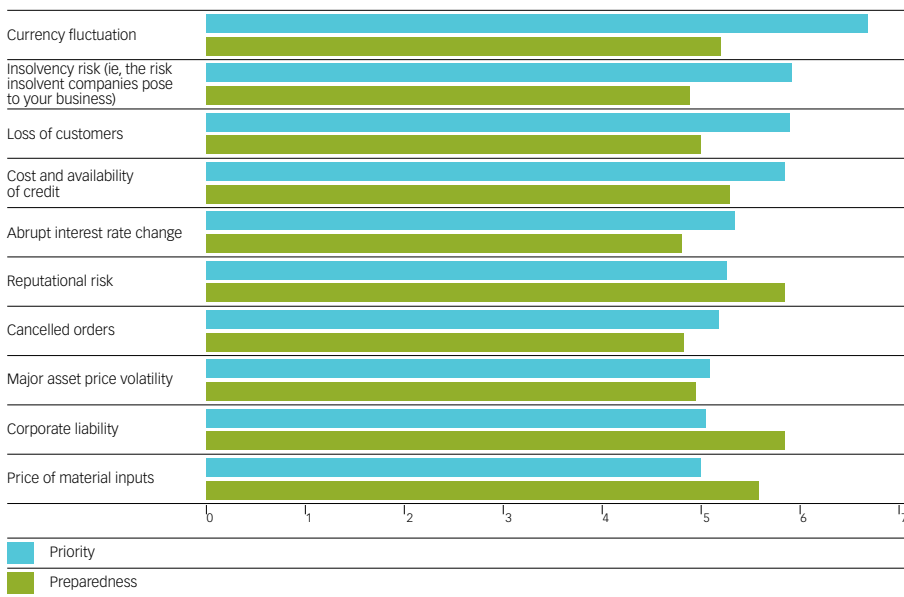
Western Europe is unusual in that there is no single risk in the top five priority list that significantly exceeds the perceived severity among the global respondents. Only in the case of concerns about insolvency risk is there any real discrepancy, but even here it is relatively minor.

PRIVATE CONSUMPTION IS FALLING MARKEDLY ACROSS EASTERN EUROPE.



REGIONAL RISK OVERVIEW: EASTERN EUROPE

Chart 12: The top ten risks Eastern Europe



“MANY CURRENCIES IN THE REGION TUMBLED SHARPLY FROM LATE 2008, AND REMAIN POTENTIALLY VOLATILE.”

Eastern Europe is particularly vulnerable to the global financial and economic crisis owing to a combination of high reliance on external finance to fuel growth in recent years and strong export dependence on weakening West European markets. The Economist Intelligence Unit now expects the region’s economy to contract by 4% this year. Unsurprisingly, risks related to the downturn are therefore high on the agenda for companies operating in the region.

The leading priority for companies in Eastern Europe is currency fluctuation. Following several years of steady appreciation, many currencies in the region tumbled sharply from late 2008, and remain potentially volatile. Although this will benefit exports from the region, it will attract concern from producers in countries that rely on imported components. The trend has also caused problems for companies that deployed expensive hedging strategies against the expectation of continued currency appreciation. These firms will have suffered heavy losses from the opposite outcome – in Poland, for example, the financial regulator estimates potential losses at US\$2.8bn.

The next highest risk priority is insolvency risk. Economic recession and tightened credit conditions are expected to result in a wave of corporate bankruptcies in Eastern Europe. The highest-profile default so far has been Kazakhstan’s largest bank, BTA Bank. However, it is unlikely to be the last – there remains some US\$700bn of debt that needs to be rolled over in the region this year, the vast majority of it from corporates and banks. As elsewhere in the world, companies do not consider themselves to be

**“SHARP FALLS
IN REGIONAL
CURRENCIES
OVER RECENT
MONTHS HAVE
PUSHED UP
THE COST OF
IMPORTS.”**

well prepared for this scenario, probably owing to the unexpectedly sharp impact of the downturn. Moreover, bankruptcy regimes are generally weaker in Eastern Europe than in OECD economies, with the process of winding up a business significantly more costly and time-consuming.

The third leading priority is loss of customers. Private consumption is falling markedly across Eastern Europe, partly because the credit boom of recent years has ended and left households struggling with substantial debt, and also because wage growth is now slowing and unemployment is rising. Again, having generally not expected such a severe economic downturn, companies are not well prepared for this eventuality, in Eastern Europe and in other regions of the world.

Companies are also particularly concerned about the risk of an abrupt interest rate change and feel less prepared to manage this risk than their global counterparts. The combination of an economic crisis and downward pressure on regional currencies has increased the volatility of monetary policy. Before the crisis hit, there had been an expectation that interest rates would steadily converge with euro zone levels as Eastern European countries prepared to join the bloc in the not-too-distant future, but the dislocation created by the economic downturn has cast considerable doubts over progress towards euro zone entry.

Price of material inputs is also a top-ten risk priority in Eastern Europe, attracting a level of concern that is substantially above that of its global ranking of 17th. The main reason for this is likely to be that, although prices for material inputs have fallen sharply around the world since the middle of 2008, many countries in Eastern Europe face further rises in the price of natural gas from Russia, their main supplier, as it seeks to raise formerly discounted prices to West European levels. There are also dangers that supply disruptions could drive up prices. In January 2009, Russia shut down supplies of gas to Ukraine, leading to gas shortages in a number of countries in the region. Another issue is that many companies in Eastern Europe import a relatively high proportion of their material inputs, and sharp falls in regional currencies over recent months have pushed up the cost of imports.

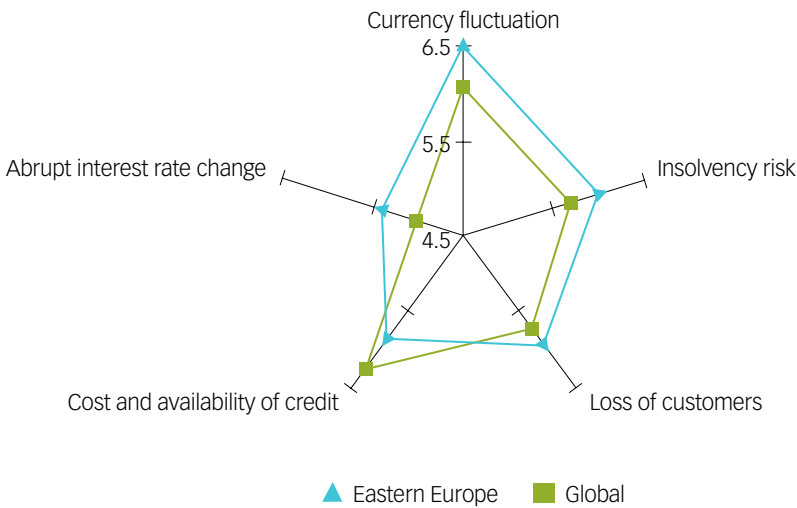
Companies appear unduly sanguine, however, about political risks. The highest placed political, crime and security risk for the region is fraud and corruption, ranked in 17th place, and this is a priority that companies claim to be well prepared to meet. This is unsurprising, given that fraud and corruption are longstanding weaknesses of business environments in the region, and companies are well accustomed to dealing with these problems. The risk of riots and civil commotion is also seen as a low priority, occupying 39th place. One might have expected this risk to have been ranked higher

up the list, given that underlying weaknesses of democratic systems in the region and the economic downturn have considerably raised political risks, and in particular the risk of civil disturbance, as witnessed in Latvia and Lithuania at the start of this year. Companies consider themselves well prepared for this risk, but political instability could be more extensive and sustained than they expect.

Compared with the global respondents, executives from Eastern Europe seem to be relatively unprepared to manage their main risk priorities. For the top five priorities in this region, levels of preparedness lag behind those among the aggregate group, especially for currency fluctuation and abrupt interest rate change.

**“POLITICAL
INSTABILITY
COULD BE MORE
EXTENSIVE AND
SUSTAINED
THAN THEY
EXPECT.”**

Chart 13: Top five risk priorities – comparison between Eastern European and global respondents



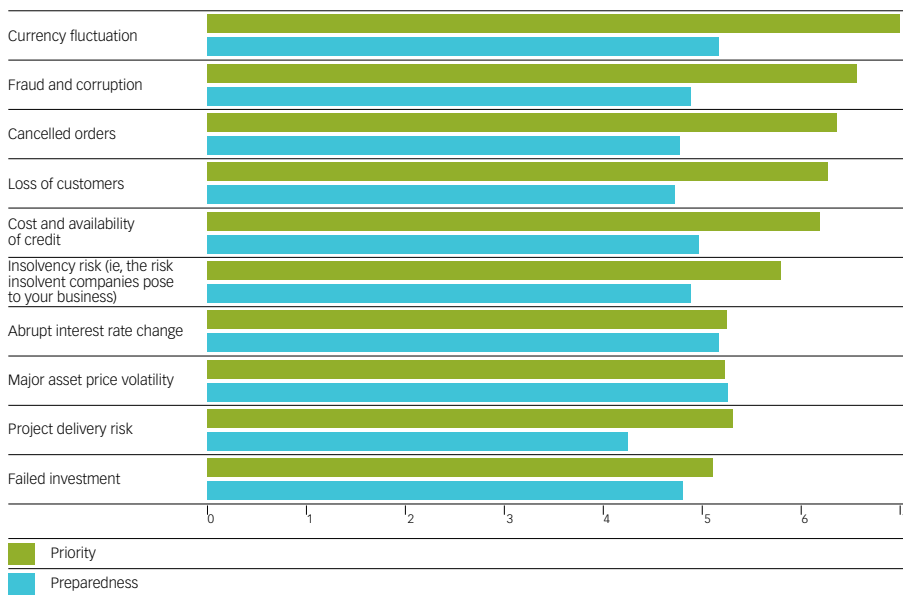
Risk priorities in Eastern Europe generally match those of global respondents overall, although currency fluctuation stands out as a greater problem in this region than elsewhere in the world.

UNEMPLOYMENT HAS BEEN INCREASING IN RUSSIA AND REAL INCOMES AND CONSUMPTION ARE DECLINING.



REGIONAL RISK OVERVIEW: RUSSIA

Chart 14: The top ten risks for Russia



“RENEWED PRESSURE ON THE CURRENCY APPEARS UNLIKELY, UNLESS THERE IS ANOTHER DRASTIC FALL IN THE OIL PRICE”

As is the case for other regions, risks related to the recession are leading priorities for companies in Russia. The country has been hit very hard by the global economic crisis. Significantly lower commodity prices, tightened credit conditions and reduced external demand mean that industrial output has been falling markedly in recent months, unemployment has been increasing and real incomes and consumption are now also declining. Real GDP is forecast to contract by 5% in 2009.

The leading priority risk for companies in Russia is currency fluctuation. The sensitivity to this risk, however, appears exaggerated for Russia in view of recent developments. Following the spread of the global financial crisis to Russia, the rouble came under strong pressure. The Russian Central Bank (RCB) was intent on avoiding a large, uncontrolled devaluation, and intervened heavily to manage the rouble's decline, with foreign reserves falling by more than US\$200bn from their peak in August 2008 to their value in early 2009. The RCB's policy of a managed decline appears to have been successful: as a result of the considerable depreciation that occurred, there has been some strengthening in international oil prices and a tightening of monetary policy. Although some further moderate weakening of the rouble is expected, renewed pressure on the currency appears unlikely, unless there is another drastic fall in the oil price.

The next highest priority risk for Russia is fraud and corruption. By contrast, this is ranked globally as only the 15th highest risk of concern. Business surveys traditionally place corruption high on the list of obstacles to doing business in Russia and tend to

“MOST TRADE UNION ORGANISATIONS ARE CLOSE TO THE GOVERNMENT AND PROTESTS ARE LIKELY TO REMAIN ISOLATED AND LOCALISED.”

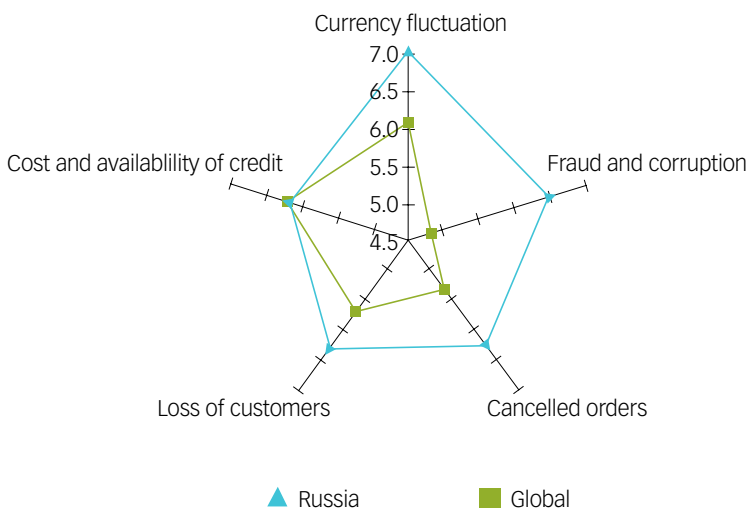
agree that corruption has been getting worse in recent years. In the 2008 corruption perception index from Transparency International, the country was in joint 147th position with Bangladesh, Kenya and Syria. President Dmitry Medvedev has made the fight against corruption a priority, although it is unlikely that there will be significant progress in the short-term.

Given recent trends in Russia, there are some risks that are perhaps surprisingly assessed as being of comparatively low priority. These include the risk of increased protectionism (ranked only 22nd compared with 16th globally, even though Russia has been resorting to increased tariffs and other protectionist measures), and the risk of other political and security risks. Unemployment in Russia has been increasing sharply and real incomes are declining. Russia also has characteristics that tend to place countries at high risk from political unrest, such as widespread inequality, low public trust in institutions, high corruption and a past history of instability. However, companies do not see the risk of ‘riots and civil commotion’, or ‘strikes’ as serious concerns; these ranked in 29th and 33rd place, respectively, on the list of priorities.

Companies are not necessarily wrong to be sanguine about these risks. Security risk may not be much higher in Russia’s large urban centres than in some other European capitals, with risk confined mainly to the North Caucasus. The incidence of violence against businesses has diminished in comparison with the first half of the 1990s. Given the lack of a credible opposition, it seems doubtful that the rise in social discontent could threaten the leadership. Most trade union organisations are close to the government and protests are likely to remain isolated and localised.

In general, preparedness levels in Russia are low: indeed, there is no single risk in the top ten for which levels of preparedness exceed the priority level. This may reflect a number of trends: first, the relatively low level of maturity in risk management within the country, and second, the political and economic uncertainty that can make doing business unpredictable in relation to some other regions in the survey.

Chart 15: Top five risk priorities – comparison between Russia and global respondents



**“PREPAREDNESS
LEVELS IN
RUSSIA ARE
LOW.”**

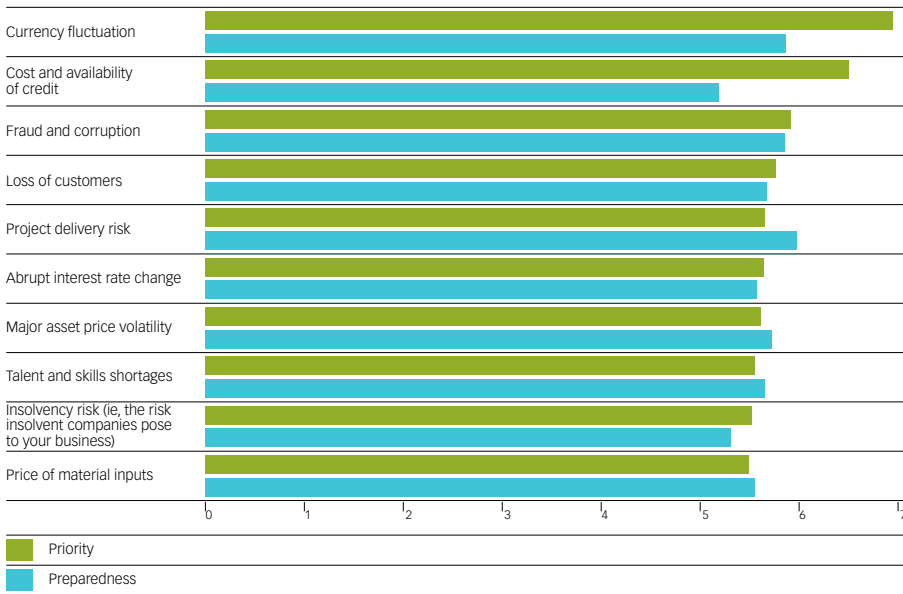
Other than for cost and availability of credit, the scale of risk priority in Russia for the top five risks far outstrips the perception among global respondents overall. This is particularly true of fraud and corruption.

THE RISK OF FRAUD AND CORRUPTION IS SEEN AS A SIGNIFICANTLY HIGHER PRIORITY IN THE MIDDLE EAST AND NORTH AFRICA THAN IT IS GLOBALLY.



REGIONAL RISK OVERVIEW: MIDDLE EAST AND NORTH AFRICA

Chart 16: The top ten risks for the Middle East and North Africa



“THE MOST CRITICAL RISK IN THE REGION WAS CURRENCY RISK.”

The key risk priorities in the Middle East and North Africa (MENA), as in most other regions, are related to the economic downturn, but there are significant differences between this region’s risk perceptions and those of the global respondents. The most critical risk in the region was currency risk, which reflects the sharp movements in global exchange rate trends over the past year and the weakening of many emerging market currencies in recent months. This made it more difficult for companies in the region to plan financial and hedging strategies. In many of the major economies in the MENA region, including the six states of the Gulf Co-operation Council (GCC), there is also some uncertainty regarding the pace and nature of planned currency reforms, and this could be adding to levels of concern. Five of the six GCC member states - Bahrain, Saudi Arabia, Kuwait, Qatar and the UAE - have affirmed their commitment to a Gulf single currency but the timeline has not been finalised, and their target date monetary union at the start of 2010 is likely to be missed.

The cost and availability of credit is a global concern, but one that has probably hit the MENA region somewhat later than most developed economies, given the spill-over effects of high oil prices on liquidity in the region. Nevertheless, it ranks second on the priority list for companies in the region. New credit grew at dramatic rates during 2007 and much of 2008, but there has been a sharp cutback since late 2008. Although central banks in the Gulf have said they will provide support to the financial sector and ensure continued liquidity for investment plans, some firms in certain sectors, particularly in Dubai, where many large foreign companies have regional bases, continue to face problems.

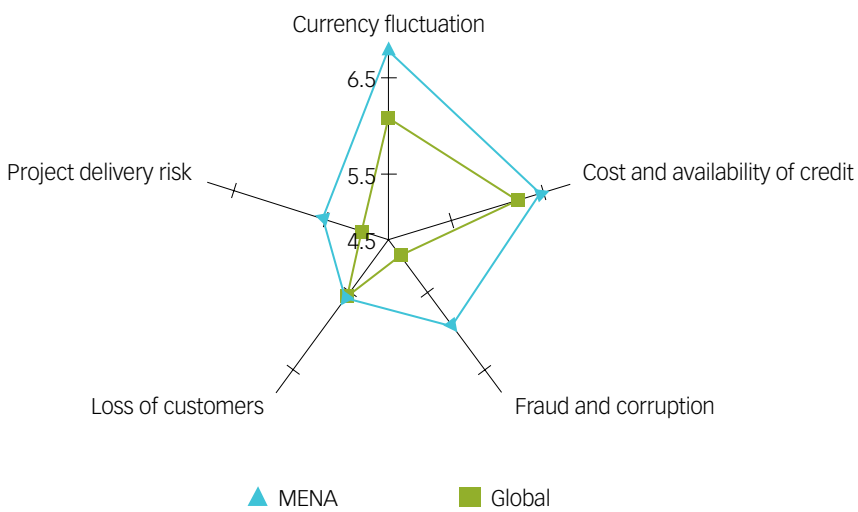
**“THERE
ARE ALSO
WIDESPREAD
CONCERNS
OVER FRAUD IN
THE REGION.”**

The risk of fraud and corruption is also seen as a high priority in MENA – indeed, the only two regions in which this attracts greater concern are Latin America and Russia. Levels of petty corruption can be fairly high even in those MENA states where the business environment has improved considerably. According to the anti-corruption organisation, Transparency International, many of the countries in the Middle East still score poorly on corruption indicators, even though, with the exception of Saudi Arabia, the Gulf Arab states are generally seen as less problematic. There are also widespread concerns over fraud in the region. According to some analysts, firms in MENA lose around 20% of their revenue to leakage, through billing errors, fraud and poor systems integration.

Talent and skills shortages score more highly on the priority list in this region than elsewhere in the world. In the Gulf Arab states, many locals are reluctant to work in the private sector or in more physically demanding roles, forcing many international firms to look overseas for the bulk of their recruits, despite government policies in those countries aimed at encouraging greater employment of locals. Elsewhere in the region, despite the high number of university graduates in many of the North African states, international employers have often complained that candidates of the highest calibre and skills set are difficult to recruit.

A general point about preparedness levels in this region is that they tend to be higher, in relation to the risk concerned, than in most other emerging market regions. In the case of four out of the top ten risks, levels of preparedness exceed priority levels, whereas for several other risks, the difference is not significant. One possible explanation for this is the level of government involvement in business in some countries in the region – this provides a safeguard that companies in more market-driven economies simply do not possess.

Chart 17: Top five risk priorities – comparison between Middle East and North Africa and global respondents



“THE LEVEL OF GOVERNMENT INVOLVEMENT IN BUSINESS PROVIDES A SAFEGUARD.”

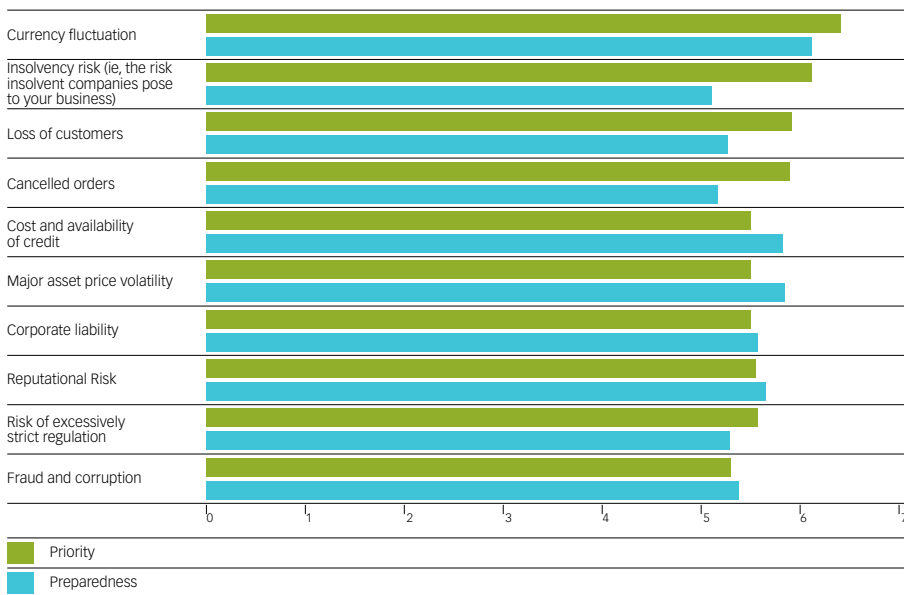
Fraud and corruption is perceived as a significantly more acute risk among Middle East and North African respondents than among global respondents overall, as is, to a lesser extent, currency fluctuation. Other risks in the top five are broadly similar to their priority among the global set of respondents.

**DEPENDENCE ON
OVERSEAS MARKETS
AND SUPPLY CHAINS
WILL ALSO ACT AGAINST
THE ABILITY OF FIRMS TO
MITIGATE THE RISK OF
LOSING CUSTOMERS.**



REGIONAL RISK OVERVIEW: SOUTH-EAST ASIA

Chart 18: The top ten risks for South-East Asia



“SWINGS IN CURRENCY RATES CAN HAVE A DRAMATIC IMPACT ON EARNINGS.”

South-East Asia is a highly diverse region that encompasses countries with a broad range of cultures and economic systems. Certain risks, however, are common throughout the region. Compared with many other parts of the world, there is a high degree of dependence on trade and many risks in the top ten are related to the impact of the global economic downturn on importing and exporting. For example, the most pressing region-specific concern for executives in South-East Asia is currency fluctuation. With many companies engaged in the sale of goods to overseas markets or making use of cross-border supply chains, swings in currency rates can have a dramatic impact on earnings. As such, there is a greater need for hedging against currency volatility. Concerns over currency fluctuation also reflect the fact that exchange rate volatility in South-East Asia has risen significantly since the 1997-98 Asian financial crisis, when many of the region’s leading exporting countries saw a breakdown of their heavily managed fixed exchange rate regimes.

Insolvency risk is ranked second on the risk priority list, which is similar to the global aggregate view. While executives in South-East Asia feel just as prepared for insolvency risk as their global counterparts overall, there is likely to be quite a range of perspectives across this diverse region. In Singapore, for example, although concerns exist over insolvency risk, the robust legal system, which offers greater protection for creditors, may help to support greater levels of preparedness in relation to other countries in South-East Asia, which have less developed legal and regulatory systems.

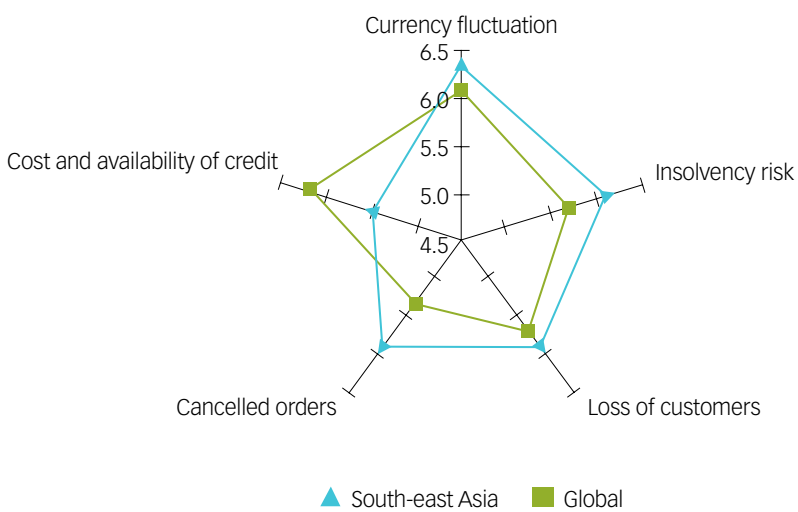
**“COMPANIES
ARE NOT
MANDATED
AT NATIONAL
LEVEL TO AVOID
CORRUPTION.”**

Concern over loss of customers is ranked highly in South-East Asia. The management of customers has its own particular characteristics in this region, where much depends on building relationships. This can sometimes reduce the risk that customers will change suppliers, purely on the basis of commercial decisions. On the other hand, dependence on overseas markets and supply chains will also act against the ability of firms to mitigate the risk of losing customers.

Fraud and corruption reaches the top ten priority list in South-East Asia, although this particular risk is less of a concern than in some other regions. According to an index compiled by Transparency International, the level of corruption within countries in South-East Asia ranges greatly, with scores ranging from 1.3 points for Myanmar, which is jointly ranked 178th out of 180 countries, to 9.2 for Singapore, placed 4th (a score of ten denotes the lowest risk and one is the highest risk). This diversity makes it hard to generalise about the experiences of executives in the region as a whole. The cross-border nature of many businesses operating in South-East Asia may also skew risk perceptions because the stage of development among countries is varied. Cross-border regulations are usually more onerous than in domestic markets, particularly where the countries concerned have less developed regulatory regimes and are prone to protectionism. In addition, it is more accepted in South-East Asia than in some other regions of the world that corruption may be unavoidable, and companies are not mandated at national level to avoid corruption, as they are in some developed countries.

In general, respondents in South-East Asia report generally high levels of preparedness to manage the threats that they face. With five out of the top ten risks, preparedness levels exceed the level of priority – a rate that is higher than in many developing, and developed regions.

Chart 19: Top five risk priorities – comparison between South-East Asian and global respondents



**“ASIAN BANKS
HAVE NOT BEEN
AS SEVERELY
AFFECTED BY
THE FINANCIAL
CRISIS.”**

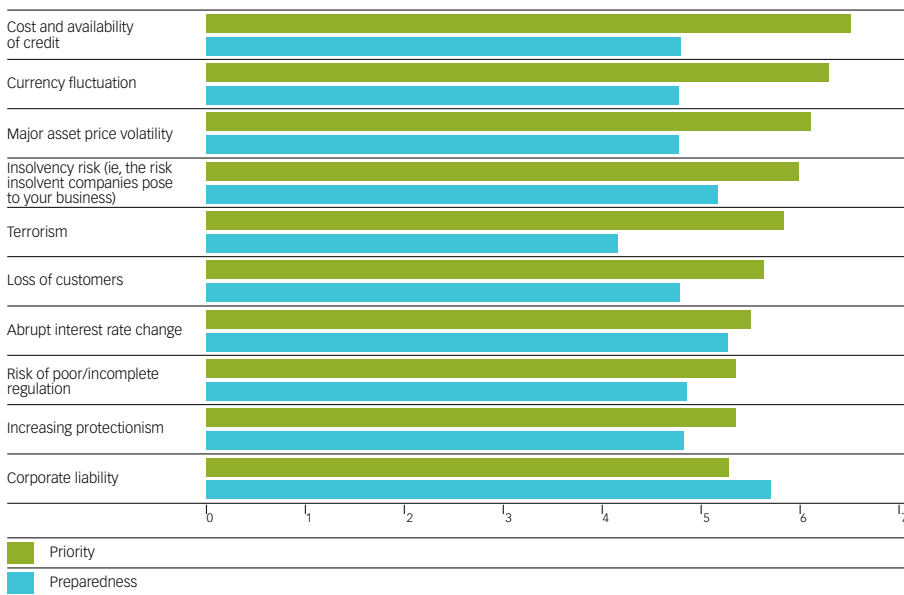
Risk priorities in South-East Asia broadly match those of global respondents overall, with the exception of one risk: the cost and availability of credit. Here, the priority level is considerably lower than in many other regions, which is perhaps a reflection that, in general, Asian banks have not been as severely affected by the financial crisis as some other regions of the world.

RESPONDENTS IN SOUTH ASIA CITE TERRORISM AS THEIR FIFTH-HIGHEST RISK PRIORITY.



REGIONAL RISK OVERVIEW: SOUTH ASIA

Chart 20: The top ten risks for South Asia



“COMPANIES ACROSS THE REGION STILL FACE VARIOUS RESTRICTIONS ON THEIR ABILITY TO USE DERIVATIVES TO DIVERSIFY THEIR FINANCIAL RISKS.”

Many companies operating in South Asia are finding it increasingly difficult to obtain sufficient amounts of credit at a reasonable price, supporting the finding that the cost and availability of credit is of prime concern. India, for example, does not generate sufficient savings to meet the demand for corporate loans in the domestic economy, and its flow of funds is not necessarily into the most productive areas – despite the fact that it has a modern banking system and a functioning national stock market.

The diverse nature of the companies operating in South Asia makes it difficult to draw overall conclusions as to why such a high priority is assigned to currency fluctuation, except as a general reaction to the economic crisis. Many leading companies in India, for example, are increasingly reliant on external markets, particularly in the services sector. At the same time, companies focused on domestic markets have to rely on imported raw materials, the price of which will change depending on broader currency movements.

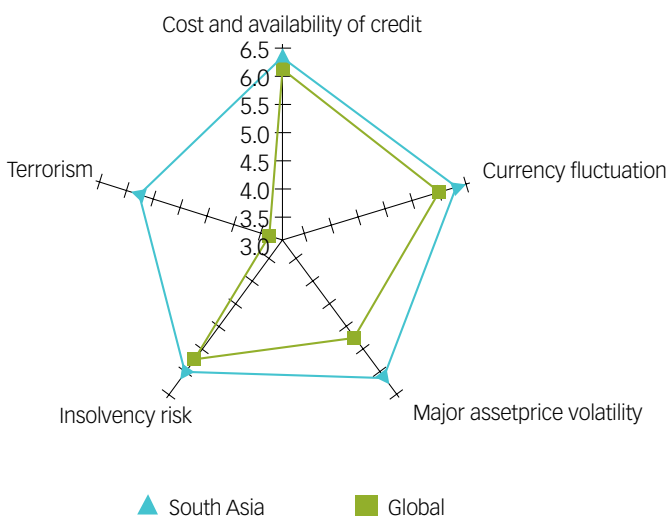
Major asset price volatility is particularly important in South Asia, where domestic providers of debt still rely heavily on the ability to seize collateral in the event of debt default. Executives in the region are concerned about their preparedness to meet this risk, which is likely to be a reflection of the inadequacy of the domestic financial system. For example, companies across the region still face various restrictions on their ability to use derivatives to diversify their financial risks.

“PROTECTION AGAINST TERRORIST ATTACK IN THE REGION WILL BE EXTREMELY DIFFICULT FOR COMPANIES TO ACHIEVE.”

South Asia has been the source and location of many of the individuals who have been involved in suicide bombings across the world. It has long been recognised that many suicide bombers have links with Pakistan, and that attacks by Islamic fundamentalists occur with regularity in India – a high-profile attack in India in late 2008 no doubt increased concerns over this issue in the months leading up to this survey being conducted. As a result, respondents cite terrorism as their fifth-highest risk priority. Protection against terrorist attack in the region, however, will be extremely difficult for companies to achieve. The random nature of attacks make it prohibitive for companies to fully protect their operations against such attacks (hence the low ranking in terms of preparedness). Even governments in the region remain unable to commit sufficient resources to remove the threat of terrorism.

In common with other emerging market regions in the survey, preparedness levels for top ten priority risks are relatively low. This is particularly true of terrorism, a problem that has recently become considerably more severe, and with which governments and businesses are only now beginning to grapple. The only risk for which preparedness levels exceed priority is corporate liability. This is likely to reflect the relatively robust legal system found in the region’s largest economy, India.

Chart 21: Top five risk priorities – comparison between South Asia and global respondents



**“THE RECENT
ATTACKS
IN MUMBAI
ENSURE THAT
IT (TERRORISM)
IS FRONT OF
MIND FOR
BUSINESSES.”**

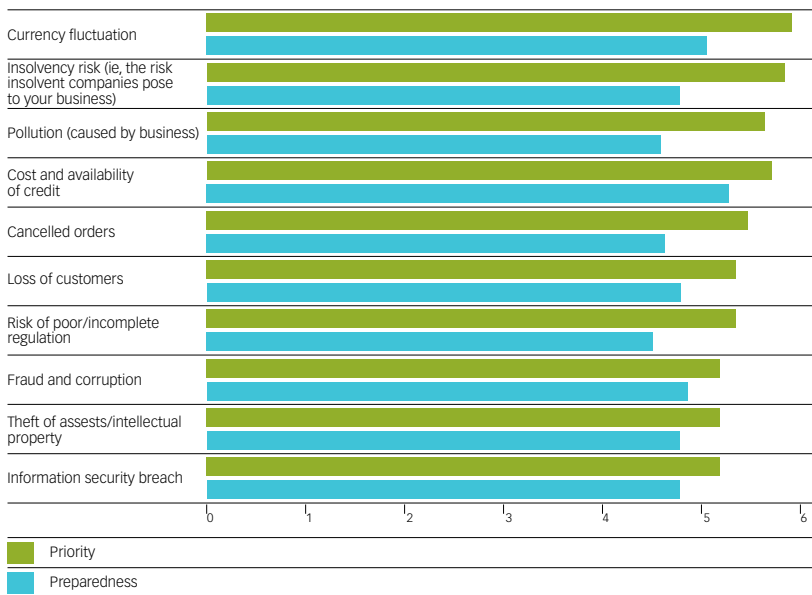
Terrorism is the major outlier in a comparison of South Asian risk priorities with global respondents overall. While terrorism as a threat seems to have slipped down the priority list for many executives in the survey, the recent attacks in Mumbai ensure that it is front of mind for businesses in South Asia.

POLLUTION RISKS WERE THE THIRD HIGHEST PRIORITY FOR RESPONDENTS IN CHINA.



REGIONAL RISK OVERVIEW: CHINA

Chart 22: The top ten risks for China



“SMALL EXCHANGE RATE FLUCTUATIONS CAN AFFECT THE PRICE OF EXPORTS OR IMPORTS ENOUGH TO RENDER BUSINESSES UNECONOMIC.”

It is interesting to observe how similar some of the top business concerns in China are to other parts of the world. Of the top six concerns for respondents globally, five match China’s top six priorities – all except pollution. But where China differs, it does so quite significantly. Pollution, fraud and corruption, theft of assets and information security breach, which appear in China’s top ten, are all ranked below the top 15 concerns of global respondents overall.

Top of the list of priorities in China was the risk of currency fluctuation, despite the country’s heavy management of its exchange rate. Part of the explanation lies in persistent speculation that the currency remains undervalued, and so could appreciate sharply. Another lies in the tight margins under which many firms operate, which mean that small exchange rate fluctuations can affect the price of exports or imports enough to render businesses uneconomic. The exodus of low-cost export manufacturers from industries such as shoe production to cheaper production bases in South-East Asia over the past two years has shown how even the slight appreciation since 2005 has made some sectors uncompetitive.

The risk posed by insolvency was the second biggest risk priority for respondents in China. The current economic downturn has increased the chance of businesses suffering insolvency problems, and the country has a notoriously underdeveloped insolvency process, so reclaiming debts owed can be challenging. Although legal systems are more developed in some parts of the country, such as Shanghai,

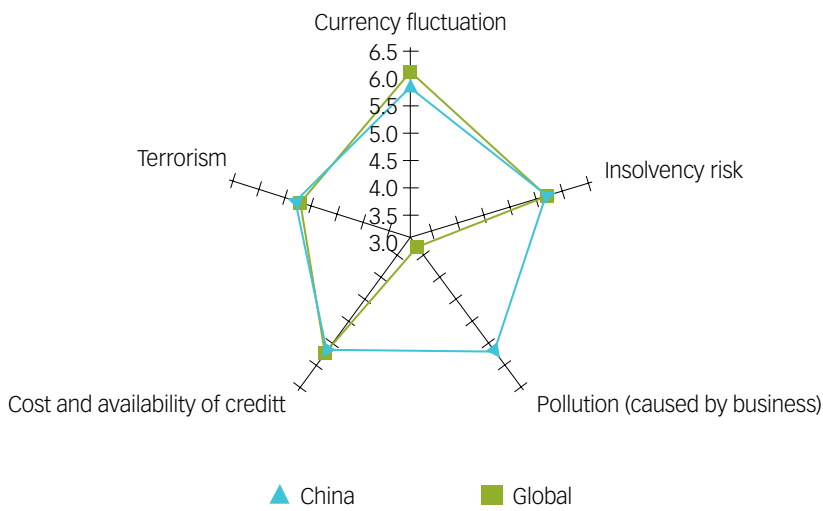
**“ATTITUDES
TOWARDS
PREPAREDNESS
ARE STRIKING IN
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LOWER.”**

enforcement of court decisions is inconsistent. Meanwhile, it can be hard to judge the financial situation of firms, not least because of unreliable auditing standards.

Pollution risks were the third highest priority for respondents in China, in stark contrast to the rest of the world, where this was much less of a concern. This discrepancy reflects both the high incidence of the problem within China, but also the increasing political attention paid to pollution and related environmental issues. Companies struggle to maintain pollution standards in their own firms and in their supply chains, and problems in either can have a damaging impact on business reputation. Government officials have also been placing a growing amount of emphasis on tightening standards, with foreign enterprises especially being held to account if problems are uncovered.

Attitudes towards preparedness in China are striking in that they tend to be much lower than most other regions in the report – only in Latin America and Russia is there a similar level of low preparedness in relation to the top ten risks. While this may reflect a cultural bias, it could also be a function of a number of other factors, including the problems that businesses have in dealing with the government’s approach to policy-making. There may also be a sense that, with the economy growing more strongly than in other regions, flexibility is a more valuable quality for companies than preparedness.

Chart 23: Top five risk priorities – comparison between China and global respondents



“POLLUTION IS A STAND-OUT RISK FOR CHINESE RESPONDENTS.”

Pollution is the stand-out risk for Chinese respondents. It is a significantly greater concern for respondents here than for global respondents overall. The other four top-five risks closely mirror the global perceptions.

RISK ATTITUDES IN AN ECONOMIC DOWNTURN

“THERE ARE A FEW BUSINESS OPPORTUNITIES THAT DO NOT REQUIRE AN ASSUMPTION OF RISK.”

Corporate growth and entrepreneurial success are predicated on a willingness to take calculated risks. There are few business opportunities that do not require an assumption of risk, and any decision to proceed with a strategic initiative will depend on an assessment of the rewards, gained through a given level of risk.

However, it is clear that this rational risk/reward trade-off can become skewed by external factors. During the boom years, companies were only too willing to increase their appetite for risk and, one could argue, often failed to conduct the kind of diligent assessment of potential pitfalls that is necessary for a strategic initiative. From merger and acquisition deals with record leverage ratios to risky market-entry strategies based on optimistic growth assumptions, there are many examples from recent years that demonstrate how risk can become decoupled from expected reward.

Our survey of 570 board-level executives suggests that, in the current environment, the pendulum has swung to the other side. For many companies, now is the time to cut costs, postpone investments and to rein in risk appetites until conditions improve. Among the senior executives questioned for this survey, 50% said they are reducing their risk appetite compared with this time last year. In general, respondents from emerging markets seem more inclined to reduce their risk appetite than those from developed markets (see chart below). Respondents from Russia, Eastern Europe and Latin America are most inclined to have reduced their appetite for risk, a reflection no doubt of the reduction in availability and increased cost of credit that has affected these markets so severely (see Lessons from Chile case study).

LESSONS FROM CHILE - SQUEEZING YESTERDAY'S PIONEERS: CHALLENGES IN ACCESSING CAPITAL

As in many regions, the cost and availability of credit is near the top of the priority list for companies in Latin America. The issue is becoming especially acute in emerging markets, as a flight from risk by global financial institutions squeezes out financing that was previously available.

Recycla Chile, the only business-to-business electronic waste-recycler in Chile, recognised in 2008 as a technology pioneer by the World Economic Forum, is one company that is feeling the pinch. Despite the strong monetary and fiscal measures of the Chilean government to support

economic growth, Recycla, which counts Hewlett-Packard, Epson and IBM as its customers, is struggling to raise US\$500,000. Earlier this year, Chile's government announced a US\$4bn (equivalent to 2.8% of GDP) rescue package and has eased its interbank lending rate from 4.75% to 1.75% since December 2008.

However, while Fernando Nilo, Recycla's founder and CEO, welcomes these measures, he says there are two main reasons as to why they are not working. First, although the central bank has cut interest rates, local banks have failed to pass these benefits on to the customer. Second, banks are thinking far more carefully about what projects and activities they should finance. "It is difficult to get anybody to even consider a project," says Mr Nilo.

Recycla is currently reviewing a number of financing options, including an approach to the International Development Bank in Washington, which offers better repayment terms than the company's local bank. But if this fails, Recycla will have no choice but to accept the terms of its local bank. However, Mr Nilo realises that even this is not guaranteed, so he is also actively seeking out private finance from investors with an interest in social business.

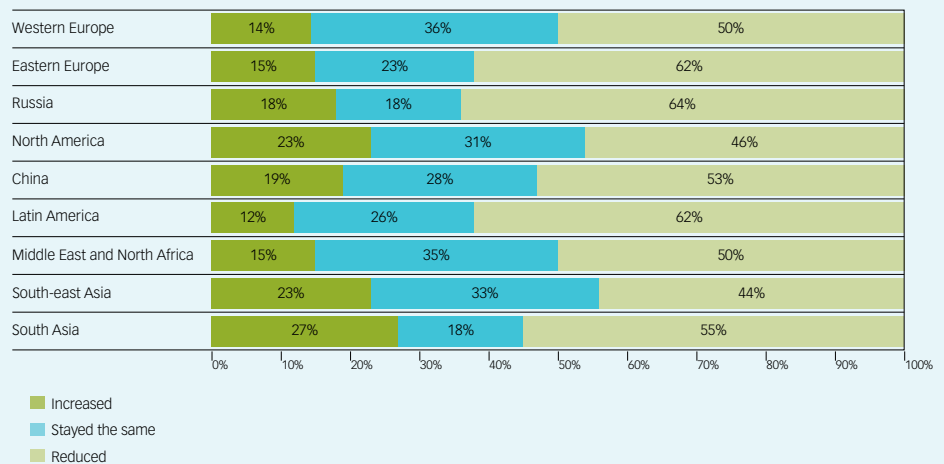
Mr Nilo believes the worst is still to come. "January, February and March were business as usual," he says. "But we are increasingly hearing that our customers are reducing expenditure and that in turn affects our cash flow." Despite Chile's strong position, which is helped by positive central bank intervention, the mood is one of uncertainty. "Ask me in a month or two whether we have been successful [in raising capital]," concludes Mr Nilo.

**"RISK
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In addition to a reduced willingness to enact strategic initiatives, a reduction in risk appetite also means that management and investors will be seeking greater assurance that the appropriate controls, monitoring and insurance contracts are in place. At a time of greater risk aversion, a desire for protection from the downside is just as prevalent as a reluctance to exploit the upside. As a result, risk management is likely to move to a more central position in strategic and operational management, and stakeholders from across the spectrum will want to be sure that potential threats have been systematically considered.

“STAKEHOLDERS ARE APPLYING FOR GREATER SCRUTINY TO BOARDROOMS THAN EVER BEFORE.”

Chart 24: Change in risk appetite



This chart displays the regional findings based on the survey question “Compared to one year ago, has your organisation’s appetite for risk (defined as your organisation’s willingness to take risks in order to grow) increased/stayed the same/decreased?”

One aspect of this is that stakeholders are applying far greater scrutiny to boardrooms than ever before. “A lot of what has gone wrong in the economy may be deemed to be outside the control of corporates, but there is a clear recognition that stakeholders will be less willing to tolerate anything else going wrong,” says John Merkovsky, global leader of the risk consulting practice at Marsh Risk Consulting. “This has provided strong encouragement for executives to sharpen their focus on risk issues.”

This can lead companies to explore a more systematic approach to considering the risks that they face. Many companies will have a constantly updated risk register, which details key strategic risks for the business, and assesses their potential impact on the organisation. Depending on the organisation, these may go beyond the traditional risk categories, or risks that are considered incidental by most other companies may come to the fore (see Coca-Cola case study).

COCA-COLA CASE STUDY - FOR WANT OF NATURAL RESOURCES

Companies in North America, as in other regions of the world, tend to place risks related to water, such as floods and drought, and more general risks related to climate change, near the bottom of their priority list. Some organisations, however, are starting to consider one of the potential issues arising from climate change - water scarcity - more carefully. One company that takes this very seriously is Coca-Cola. It is hardly surprising that

“scarcity and poor quality of water” is reported as a strategic risk by the company. Water is the main ingredient in most of its products, but it is only since 2003 that the issue of water quality and availability has become a significant enough risk to hit the corporate radar at a strategic level.

This risk is now addressed systematically by the company. In 2004, Coca-Cola launched a comprehensive water initiative, assessing availability at plant-level operations in the 200 countries in which it operates and across its almost 1,000 franchised bottling plants.

The risks that the company has identified go beyond physical water scarcity. “Whether it’s aging infrastructure in the US or the lack of municipal water and sanitation services, you can have a water scarcity issue that might have nothing to do with the physical amount of water available,” explains Greg Koch, head of the global water stewardship programme at Coca-Cola.

The company has developed modelling tools to help it forecast a variety of water-risk scenarios and tackle its water use more effectively. Part of this has meant continuing efforts to reduce consumption, treat and reuse water where possible and ensure that waste-water is safe and clean.

Although these measures have helped Coca-Cola to manage its own water consumption more efficiently, they have also highlighted the importance of considering external factors, such as the health of global watersheds and conservation of the world’s freshwater resources. “What really came out of the risk assessment was that it was no longer enough to focus on the four walls of the plant,” says Jeff Seabright, head of environment and water resources at Coca-Cola.

**“GREATER
SENSITIVITY
TO RISK CAN
LEAD TO
RETRENCHMENT.”**

In some cases, however, greater sensitivity to risk can lead to retrenchment, and the postponement of investments that may, in the long-run, still be seen as consistent with the risk profile of the organisation. But in the current environment, companies are prioritising the protection of earnings and liquidity, and that is deterring them from seeking or capitalising on opportunities for the foreseeable future.

Just as companies can underestimate risk during a boom, so there may be a tendency to focus excessively on cost-cutting and operational efficiency during a downturn at the expense of future growth. “I think the biggest source of risk that is being underestimated today is the risk associated with our own moves to survive,” says

**“THERE IS A
CONSTANT
DANGER WITH
RISK THAT IT
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DEPARTMENT.”**

Eamonn Kelly, chief executive of Global Business Network, a business consultancy. “From cost-cutting and centralisation to focusing on core operations, all of the recommended measures to see us through the downturn in fact reduce organisational resilience and ability to adapt.”

One lesson from the financial crisis should be that companies need to pay greater attention to ‘tail-risks’ – events that may be of a low probability but that can have a major impact on the business. “I’m still of the view that very few businesses look at extreme tail-risks,” says James Catmur, head of Arthur D. Little’s Sustainability & Risk Practice in the UK. “They work from the premise it doesn’t happen... and because they [extreme tail-risks] don’t happen very often, you don’t get rewarded by shareholders for managing them.”

A theme that runs through the interviews conducted for this research is the need to apply judgement in conjunction with quantitative risk tools. “I have observed a much stronger emphasis recently on the exercise of judgement in making decisions and choices related to risk, which in fact is extremely healthy,” says Stephen Catlin, CEO of the Catlin Group. “An over-dependence on quantification has led to a false sense of security in recent years; the return of critical and systemic thinking in support of wise judgement in an uncertain world is an overdue correction and will serve us all well in the long-run.”

This emphasis on judgement highlights the vital role of the board and senior management in having a frequent conversation about risk. “My personal view is that the best-run companies are those where the group executives take it upon their shoulders to be the ultimate custodian of risk,” says Mr Catlin.

There is a constant danger with risk that it can be stored in a separate department or allowed to become so complex that few people in the company understand it. “One of the problems with risk is that it can become fiendishly complicated, and you can come up with hugely complicated models for analysing risk, which you may well need to do, but you have to find a way of demystifying it so people can relate to it quite simply,” says Mr Catmur.

Jacque Reynolds, chief risk officer at the global engineering, science and technology consultancy BMT, highlights the challenge of harmonising risk perceptions, which can often be driven by culture. “Somebody in America could say something is very low risk, but the same risk and the same circumstances to someone who is risk-averse in Asia could be seen in a completely different way,” he explains. “It is important to have a standardised framework and process as far as possible.”

One tendency with risk is that executives can be excessively focused on newspaper headlines rather than taking a longer-term view that looks beyond the knee-jerk reaction. “You tend to see that executives will chase specific risk issues rather than focus on the core priorities of their business and protect them from as wide a range of risks as possible,” says Mr Catmur.

According to this approach, companies should not start with the risk category and then consider how it affects every aspect of their business. Instead, they should focus on what is essential to keep the business operating and then work out what threats might have the most significant impact. “Not every part of your business is equal,” says Mr Merkovsky.

Mr Kelly believes that a fundamental reassessment of risk is required, especially in light of the shift towards more government that is expected in many regions of the world following the financial crisis. “I think that every enterprise needs to conduct, at some point over the next couple of years, a deep review of the changing nature of its dependencies across multiple forms of stakeholder groups, its key relationships and the threats to its reputational assets,” he says.

In many cases, this will require a reassessment of risk, not just within the company itself, but throughout every partnership across its value chain. The complex web of business relationships that characterise the modern corporation mean that the reputation of the company can not just be damaged by wrongdoing within the four walls of the company, but by actions taken by partners with whom the company does business. Risk management, in short, should not end at the company door (see UPM case study).

**“RISK
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UPM CASE STUDY - INVESTING IN THE ENVIRONMENT

When Finnish pulp and paper company UPM first entered the Chinese market ten years ago, it faced many of the potential threats to its supply chain that were prevalent in other developing markets: a variable quality of services and products from local producers, accompanied by weak safety and environmental standards.

A decade later, the country’s ways of doing business have been transformed by changes such as stricter environmental standards imposed by the central government and an increasingly well-enforced rule of law.

UPM has upheld strict safety and environmental standards, according to Pertti Salminen, head of Asia-Pacific UPM Paper Business Group. But its

**“RISK
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environmental expertise has also been a way to differentiate UPM from its competitors. UPM has its own code of conduct to which suppliers are expected to adhere, and is committed to ‘responsible sourcing’ of raw materials for its products.

The company’s approach to ethical and environmental standards has led it to stop working with some suppliers, despite its policy of trying to source materials locally. “In some cases, the quality is OK but the safety standards are not sufficient for us,” says Mr Salminen, adding that the company has had similar problems with some of its local suppliers of chemicals for paper manufacturing. “We had a problem with a packaging materials supplier, which had not fulfilled our environmental standards,” he says. “The quality and price of the product were set, but when we came to the environmental performance, they didn’t fulfil our requirements and survey criteria, and they were rejected.”

UPM continues to do regular surveys of its suppliers, even if there is a long-term relationship in place. “The biggest challenge is to train our own people in China to carry out our own surveys,” he adds. Today, the majority of UPM’s local and foreign competitors in China are using similar compliance rules to monitor local suppliers. According to Mr Salminen, any foreign companies that are investing in China need to be willing to put effort into their relationships with local companies if they want to maintain standards. “It’s not only giving quality specifications; you must really teach and educate your suppliers,” he concludes.

The resounding message is that risk needs to be elevated and opened up to broader, more forthright discussion. “Companies have to find a way of turning this from a compliance activity into something that means they are really managing risk,” says Mr Catmur. “Risk management is about an openness and willingness to face difficult facts. A risk, by definition, is something we don’t know the answer to. If we know the answer, it’s not a risk.”

CONCLUSION: THE IMPLICATIONS FOR BUSINESS

There are clearly similarities, especially as a result of the global economic crisis, as well as variations in how executives across the world prioritise the risks their businesses face. Certainly there are regional differences in how prepared company executives feel they are to manage emerging risks. We suggest that there are a number of clear lessons and implications for business that may be drawn from this research, which should help executives when planning and preparing their organisations for managing risk in the future.

THE ECONOMY IS FRONT OF MIND FOR BOARD-LEVEL EXECUTIVES, AND COMPANIES MUST SEEK WAYS OF MINIMISING THE IMPACT OF FACTORS OVER WHICH THEY HAVE LIMITED CONTROL.

It is entirely understandable that the economic situation looms large over corporate thinking, and companies everywhere are struggling to understand and come to terms with a dramatically changed external environment. While executives have little direct control over exogenous risks, or external factors relating to the economy, they should bear in mind that they can indirectly influence their company's trajectory during these difficult times through the strategic and operational choices that they make. They should also bear in mind that they need to extend their thinking about risk into their critical networks of partners, suppliers, customers and other stakeholders, and assess how changes in their behaviour or situation might resonate within the company itself.

MULTINATIONAL COMPANIES MUST DEVELOP A COMMON LANGUAGE AROUND RISK.

Risk lies in the eye of the beholder, and perceptions of risk can be influenced by a range of factors, from cultural values to individual levels of tolerance. For multinational companies that operate in a variety of jurisdictions, a common language and measurement of risk is essential in order to prevent varying risk perceptions from muddying the waters and clouding corporate judgement. Only then can executives make direct comparisons between situations. Equally important is the need for a common understanding of risk tolerance. If this has to be adapted, as a result of changes in the external environment, there must be a way of ensuring that the new risk tolerance can be communicated and understood throughout the organisation.

RISK IS TAKING CENTRE STAGE IN CORPORATE DECISION-MAKING, BUT EXECUTIVES SHOULD BE CAREFUL NOT TO LET THE PENDULUM SWING TOO FAR.

The financial crisis has forced a fundamental reassessment of risk. Companies in all sectors and regions are now paying greater attention to risks involved in any strategic activity, and ensuring that governance, controls and monitoring are appropriate to mitigate the threats of a changed business environment. This is encouraging, because risk has been for too long sidelined in many companies and not given sufficient authority. One implication of this change in mood, however, is that companies are retrenching from activities that could jeopardise future earnings and cutting costs to improve operational efficiency. This is an understandable reaction to unprecedented times, but companies must be careful that the pendulum does not swing too far. This means that they should also keep one eye on the medium-term and ensure that decisions taken now do not undermine agility or disable capabilities that are essential to capture future opportunities.

EXECUTIVES NEED TO LOOK BEYOND THE HEADLINES WHEN ASSESSING RISK PRIORITIES AND NOT FOCUS ENTIRELY ON SHORT-TERM ISSUES.

The survey results demonstrate how recent events can influence perceptions of risk. When low probability/high impact events occur, the relevant risk category inevitably rises up the priority list as companies ask themselves whether they are sufficiently prepared to meet the threat. This is understandable, and companies should always be looking for areas in which their exposure to risks can be minimised. But it also highlights an important point, namely that risk management can too often focus on chasing the latest problem, rather than taking a more dispassionate view of risk over a longer time-frame that takes account of a broader set of potential threats, including tail risks.

COMPANIES SHOULD FOCUS ON THE BUSINESS BUT KEEP ONE EYE ON THE HORIZON.

It is tempting in risk management to think about risk categories first, and then consider how each one in turn affects the business. But this approach ignores the fact that every company is different, will be more or less exposed to specific risks, and has different priorities in terms of keeping the business operational. A more efficient and effective approach is to adopt a dual process: first, look at the business, identify the processes and components that are essential to keep it running and then consider the threats that are most likely to cause disruption. But second, keep one eye on the horizon to ensure that the company is aware of any new, emerging risks or changes to known risks as early as possible. Using these two approaches in combination, executives in today's uncertain environment may at least be able to get some sleep at night.

THE REGIONAL DIVERSITY OF RISK HIGHLIGHTS THE NEED FOR LOCAL UNDERSTANDING AND CLEAR RISK REPORTING.

This report has highlighted some of the differences in risk perception at a regional level. For multinationals seeking to invest in overseas markets or to build a stronger international presence, it is clear that risk management must be tailored to meet local challenges and opportunities. To succeed in these markets, companies must combine an awareness of risk at a local level with the ability to understand the impact of these risks on the organisation at a global level. This highlights the importance of clear and consistent risk reporting, so that executives at the company headquarters have a clear picture of risks across their international markets.

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